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August 18, 1981

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Grain Elevator Task Force

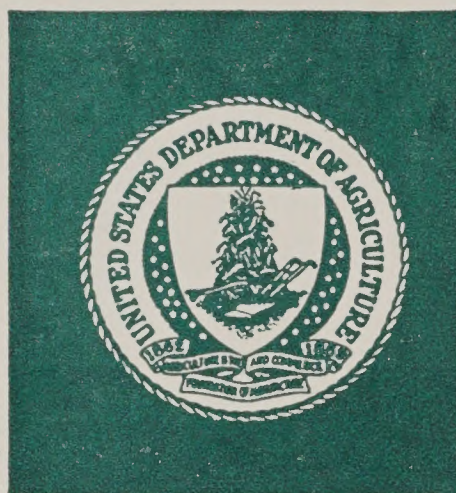
Report to the
Secretary of Agriculture



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SUBJECT: Grain Elevator Bankruptcy Report

TO: Ray Lett, Chairman, Executive Committee, Warehouse
Task Force

Our committee has completed our research of all presently available data and public impact pertaining to the problems existing in identifying and preventing elevator bankruptcies.

Since the inception of the committee February 26, 1981, by Secretary Block, we have had the task of compiling useful data that heretofore had not been available for Departmental use. Our study revealed numerous discrepancies within the Federal and State sector pertaining to adequate control and surveillance of warehouse financial and storage operations. We further found problems within the required net worth minimum prescribed by U.S. Warehouse Act and UGSA.

Our evaluation of the USDA position pertaining to prebankruptcy or bankruptcy cases showed a more passive than progressive posture. To alleviate some of the weaknesses cited by the task force, we recommend the following actions by the Secretary of Agriculture.

1. USDA initiate immediate action that would ultimately coordinate Federal-State efforts with regard to minimum licensing or agreement requirements and establish uniform minimum net worth standards, and recommend methods of auditing warehouses on grain merchandising. This action would be taken in the form of a study group consisting of Federal, State, and regulatory officials to deal with the overlapping authorities, financial expenditures, and inspection requirements dealing with related warehouses. (See Attachment I)

2. Amend the Commodity Credit Corporation Standards for Approval of a warehouse for grain, rice, dry edible beans and seed to require the following: (A) The warehousemen to file an unqualified certified statement prepared by an independent certified public accountant . 1/ (B) To increase the net worth requirements consistent with the U. S. Warehouse Act requirements. (C) To provide for the acceptance of an irrevocable letter of credit in lieu of bonds. (See Attachment I)

1/ Minimum requirements should include identification of all scale tickets with grain stored or moved in and out of warehouse.

3. (A) To increase net worth requirements of the U.S. Warehouse Act including separate additional net worth requirements for those warehouses who market grain products; (B) Require unqualified financial statement from an independent certified public accountant. 1/ (See Attachment II)
4. Establish a special USDA team consisting of ASCS, AMS, OGC, and OIG reporting directly to the Secretary with the specific purpose of dealing with warehouse problems when a suspension of the license or contract has been initiated by USDA. This act would occur prior to a bankruptcy. (See Attachment III)
5. Initiate a policy position pertaining to bankrupt elevator cases where USDA has a vested interest. The Office of the General Counsel shall be responsible for determining USDA's policy position with regard to the protection of the integrity and security of the warehouse receipt.
6. Develop a comprehensive information package to be used for the instruction and education of users of warehouse receipts which should include the type of contracts normally enacted by warehousemen; the requirements and conditions of USDA licenses and contracts with warehouses, etc. (See Attachment III)
7. Create an ad hoc committee to study USDA audit costs and sources as they relate to user fees posed by the USDA. The committee will report to C. W. McMillan, Assistant Secretary for Marketing and Inspection Services.

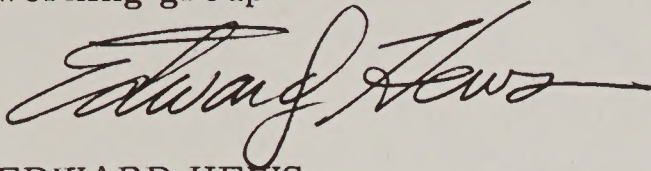
Three conditions we feel inappropriate to recommend at this time deal with an insurance or indemnity program, the establishment of a new Federal agency to deal with this problem, and a clearinghouse for information. The working group also recommends that the following alternatives not be adopted as far as CCC approval standards are concerned.

1. Require performance bonds.
2. Require that all warehouses are either licensed by the U.S. Warehouse Act or by a State which has laws and regulations comparable to the U.S. Warehouse Act as determined by AMS. (See Attachment III)
3. We recommend that the Department work toward developing a focal point, either in or out of government, for the collection of information about all bankruptcies whether they are Federally licensed, State licensed, or not licensed at all. The purpose simply is to have accurate information on a timely basis for use in determining proper policy responses.

1/ Minimum requirements should include identification of all scale tickets with grain stored or moved in and out of warehouse.

Ray Lett

We have attached support material covering the above recommendations and material used in arriving at the conclusions reached by the elevator task force working group.

A handwritten signature in cursive script, reading "Edward Hews". The signature is fluid and extends to the right with a long horizontal stroke.

EDWARD HEWS

Chairman

Elevator Task Force Working Group

Recommendations for Administrative Changes to Commodity Credit Corporation Standards for Approval

Recommendation 1: Create a study group of Federal, State, and regulatory agencies that would coordinate Federal-State efforts regarding minimum licensing or agreement requirements, establish uniform minimum net worth standards, recommend methods of auditing warehouses on grain merchandising.

Various State and Federal agencies are active in reducing risks for persons doing business with grain elevators either for storage or sale of grain. A wide variety of regulation, examination procedures, and net worth and bonding requirements exist; some are extensive, some are not; yet the purpose is the same. It is essential to the orderly marketing of agricultural products and the general welfare that a sound system exist. Too often, agencies with common goals are reluctant to share successful programs with others or to admit unsuccessful programs. The "numbers" game is played--a fear that a loss in the numbers of elevators means a failing program while an increase in numbers is taken for success--neither is quite true.

It seems to the task force that there is plenty of work to go around and that agencies should work together to do the best job possible. We, therefore, have suggested a Federal-State study group which would be of equal representation to study the common problem, to exchange information and experiences, to share accumulated knowledge, and to discuss new approaches. This committee could be the source for an effective informational program.

Recommendation 2: Amend the Commodity Credit Corporation (CCC's) Standards for Approval of Warehouses for Grain, Rice, Dry Edible Beans, and Seed as follows:

- A. Require that warehousemen file an annual unqualified certified financial statement prepared by an independent certified public accountant (CPA).
- B. Increase the net worth requirement.
- C. Provide for the acceptance of irrevocable letter of credit in lieu of bonds.

Discussion:

Recommendation A: The adoption of an annual unqualified certified financial statement was the most controversial item during the National Grain and Feed Association meeting in Kansas City. There were some warehousemen who expressed concern on the validity of such a

statement. There was also concern expressed by those firms which have a management or agent relationship with small country warehousemen. The ad hoc committee did not seem to have the concerns that were expressed at Kansas City.

We estimate that the cost of obtaining these statements may range from about two to ten thousand dollars per warehouseman. This requirement may cause many smaller warehousemen, especially those having less than 100,000 bushels in capacity, some hardships. The cost of obtaining an unqualified financial statement could impact the hardest on smaller warehousemen. It was reported that about forty to fifty percent of the warehousemen already have the services of an independent CPA, and would be able to furnish an unqualified financial statement. Assuming that these costs are already included in the storage rates submitted to CCC, the overall additional impact to CCC should not be too expensive--probably in the area of fifteen-hundredths (.15) cents per bushel per year. (We estimate that the average cost of the statement for all warehousemen would be about three-tenths (.3) cents per bushel per year.) We wish to reserve the option of modifying this requirement, if warranted by comments received after publication of a Notice of Rulemaking is made in the Federal Register.

Recommendation B: There were hardly any comments concerning a recommendation to raise the net worth requirement. The Standards of Approval of Warehouses will be amended to provide the same net worth requirement as currently required by the U.S. Warehouse Act regulations. We intend to maintain close liaison with the Warehouse Division of the Agricultural Marketing Service (AMS) so that both the Agricultural Stabilization and Conservation Service (ASCS) and AMS have similar net worth requirements at all times.

The CCC will require that all grain warehousemen have a net worth of at least \$25,000 irrespective of capacity. The basis of computing the net worth requirement will be changed from 10 cents per bushel of capacity to twenty cents per bushel. The required net worth will be the maximum storage capacity multiplied by twenty cents per bushel.

Recommendation C: The acceptance by CCC of irrevocable letters of credit as a substitute for a bond or other substitute security from warehousemen having a deficiency in their net worth was found to be very acceptable by the warehouse industry. The State regulatory agencies asked that the CCC accept such letters issued to the State. We believe that this could be accepted, but final decision may depend on an opinion from the Office of the General Counsel (OGC). We believe the adoption of this recommendation could lower storage costs. We understand that many bonding companies are reluctant to underwrite warehousemen with a deficiency of net worth and thus are requiring certificates of deposits or letters of credit be posted up front before the bond is written. The cost of the bond could be saved.

Recommendations for Changes to Federal Licensing Procedures

Recommendation 3: We recommend the following in connection with Federally licensed grain elevators:

- A. Continue to receive comments on proposed Grain Marketing Regulations in line with the Federal Register Notice of June 9.
- B. Require that warehousemen file annual certified financial statements prepared by certified public accountants (CPA's).

Discussion:

Recommendation A: After discussion of proposed marketing regulations in Kansas City June 9 and 10, it is apparent that the trade is divided in its response. As a result, AMS is proposing to have a one-day meeting with a few Federal licensees to explain the background and intent, and receive verbal comments in line with the Department's asking for written comments through August 10.

Recommendation B: The adoption of an annual unqualified certified financial statement seemed to be the most controversial item during the National Grain and Feed Association meeting in Kansas City. There were some warehousemen who expressed concern on the validity of such a statement. There was also concern expressed by those firms which have a management or agent relationship with small country warehousemen. The ad hoc committee that met here in May did not seem to have the concerns that were expressed in Kansas City.

We estimated that over half of Federally licensed warehouses already have the services of a CPA, and would have no problem furnishing a CPA financial statement. We wish to reserve the option of modifying this requirement, however, if warranted by comments received after publication of a Notice of Rulemaking is made in the Federal Register. We might find it appropriate to modify such a requirement for the smallest licensed elevators, and to specify the information that we would want.

Recommendation 4: Take steps, including asking for legislation, to protect grain claimants during the period after we suspend a license but prior to bankruptcy (if in fact the elevator goes into bankruptcy) during which we do not normally take legal actions.

Recommendation 6: Use both private and public means to provide accurate information to producers, elevator managers, bankers, and others who might have an interest in this matter. There appears to be no objection to providing information.

Recommendation 7:

Establish an ad hoc industry committee composed of warehousemen directly affected by the user fee legislative mandate relating to the U.S. Warehouse Act program. Such a committee would be beneficial to USDA, program administrators, and users of the program. Such a committee would be advised of the purposes of the program, costs of implementing those purposes, and revenue needed to meet such costs. A frank discussion of such matters would help to allay trade suspicion that costs include unnecessary expenses, that the revenue exceeds costs, and that charges are distributed indiscriminately. Such discussion would probably make more palatable the payment of user fees.

The committee could be helpful to program people in studying new or improved methods of accomplishing purposes and objectives; and in arranging for closer cooperation and coordination between warehousemen and examiners expediting examinations.

This committee also would serve as the "alert" for the Secretary to make certain that imposition and/or amount of user fees is not inhibiting or impairing effectiveness of the program.

Since much of the workload of the Warehouse Division, AMS, is concerned with examinations for ASCS of CCC-owned or loan products, ASCS would have an interest in recommendations affecting examination procedures and should be an ex-officio member of the committee.

Alternatives Not Recommended

Alternative 1:
Require
performance
bonds

The working group decided that the implementation of the requirement for the submission of an unqualified financial statement and increasing the net worth should provide CCC with sufficient added protection without requiring performance bonds. A bond required by CCC in the Standards of Approval needs to be written to CCC. They will cover only CCC-owned and -loan grain. No protection from the bond would be given to other depositors. We believe that CCC's risk is so widespread that it should be able to withstand the costs of any losses

without paying for bond costs. At levels used by AMS, the cost of bonding could amount to about \$12 million nationwide for warehouses approved by CCC. This would equal about two-tenths (.2) cents per bushel and would be passed on through increases in storage rates. A portion of this cost is already being charged because of bonding requirements of licensing authorities.

Alternative 2:
Require
Licensing
of all
Warehouses

The CCC's Standards of Approval should suffice for warehouse approvals. Prior to this study, CCC had not been aware of the desire of the States that warehouses in all States should be licensed. While this proposal had favorable response from the ad hoc committee, there still remains the question of the Federal government deciding the adequacy of the laws. Furthermore, in those States not having warehouse licensing requirements, the Federal government, through CCC, is mandating that the warehouse be licensed. The Standards of Approval are written in such a manner that they are the minimum standards that must be met for approval. Many States that already have licensing authority do not have requirements that meet these standards. We believe that adoption of this requirement is not necessary as far as CCC approvals are concerned. If producers and warehousemen wish stronger State warehousing laws or the enactment of State warehousing laws, they should make their feelings known to their State legislators.



NEWS

U.S. DEPARTMENT OF AGRICULTURE

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USDA TASK FORCE TO STUDY QUESTION OF GRAIN OWNERSHIP IN BANKRUPT ELEVATORS

WASHINGTON, Feb. 26--Secretary of Agriculture John Block today appointed a U.S. Department of Agriculture task force to review current grain warehouse laws and regulations and to recommend possible changes to safeguard the interests of both farmers and the government when a commercial grain elevator goes bankrupt.

This issue recently surfaced in New Madrid, Mo., where a group of farmers removed soybeans from a bankrupt elevator after delays were encountered in obtaining the crop through the judicial process.

Block said, "Farmers rely on the sale of crops from the previous year to pay for present operations. If farmers cannot obtain their crops from the warehouse where they placed them, they may incur losses due to their inability to continue operations. A way must be found to reduce or eliminate the loss potential."

The task force will be chaired by the acting administrator of USDA's Agricultural Stabilization and Conservation Service. It will include the executive assistant to the secretary and representatives from agencies reporting to the under secretary for international affairs and commodity programs, the acting assistant secretary for marketing and transportation services and the director of economics, policy analysis and budget.

The task force will seek the views of farm groups and the warehouse and grain trade industries to get comments from all interested parties, Block said. It will begin its work in early March.

#

Warehouse Task Force

Executive Committee

Ray Lett, Chairman	Executive Assistant to the Secretary
Seeley Lodwick	Under Secretary for International Affairs and Commodity Programs
C. W. McMillan	Assistant Secretary for Marketing and Inspection Services
William Leshner	Assistant Secretary for Economics
A. James Barnes	General Counsel

Working Group

Edward Hews, Chairman	Agricultural Stabilization and Conservation Service
Jim Springfield	Agricultural Marketing Service
Bruce Wright	Economic Research Service
Arnold Grundeman	Office of the General Counsel
Ron Sidner	Office of the Inspector General
Francis Yager	Cooperative State Research Service
Ty Matsuoka	Agricultural Stabilization and Conservation Service
Jon Meyerson	Office of Budget and Program Analysis

THE U.S. WAREHOUSE ACT

Background Information*

The U.S. Warehouse Act was passed by Congress in 1916 to improve this country's agricultural warehousing industry. When the Act was created, storage facilities were inadequate, warehousemen lacked proper control, warehouse receipts were not uniform, not universally accepted, and there were few uniform standards for grading and classification of agricultural products.

One of the most beneficial results of the Act was the establishment of warehouse receipts that are uniformly dependable and acceptable in financial circles as reliable collateral for loans.

The present system of warehouse licensing, bonding, and inspection is geared to assure receipt holders that their products will be delivered when they surrender receipts and pay storage charges.

Each depositor's goods must be stored in such a way that the depositor may recover the same product if the warehouse receipts call for separate storage, or the same amount of product of the same grade or better if stored commingled with like products of other depositors.

The Act authorizes the Secretary of Agriculture to license public warehousemen storing agricultural products who voluntarily apply for a license and who are found to qualify.

As of October 1, 1980, there were licensed under the U.S. Warehouse Act 228 cotton warehouses with a storage capacity of 9,873,000 bales; 1,808 grain elevators with a storage capacity of 3,085,283,000 bushels; and 74 warehouses storing other agricultural commodities. This represents 54 percent of the commercial cotton storage and 43 percent of the commercial grain storage. Over 70 percent of the U.S. cotton crop will be stored in a Federally licensed warehouse sometime before use. Some 30 percent of the Nation's grain producers deal with Federally licensed elevators delivering an even higher percentage of the Nation's output of grains.

To qualify for a license, a warehouseman must have a suitable and properly equipped warehouse; a good business reputation; and a minimum net worth computed according to warehouse capacity and the type of commodity stored. The warehouseman must furnish an acceptable bond in an amount fixed by USDA, employ qualified personnel with knowledge of how to weigh, inspect, and grade agricultural products; have adequate equipment to properly grade and weigh; apply on a prescribed form signed by an authorized officer; and pay initial inspection and license fees.

*Excerpted from "Warehouses Licensed Under U.S. Warehouse Act as of December 31, 1980." Agricultural Marketing Service, U.S. Department of Agriculture.

To the extent of their capacity, licensed warehouses are required under the Act to receive for storage agricultural products of the kind customarily stored, which are tendered in the usual manner in the ordinary and usual course of business and in a suitable condition for warehousing. They must not discriminate among persons desiring to avail themselves of warehouse facilities.

The Act requires licensed warehousemen to issue receipts for all stored products as evidence that the depositor's products are in storage. All such receipts, printed under government contract, must be ordered from USDA. A warehouse receipt may be issued only when the products are actually received in the licensed warehouse. Negotiable receipts must be surrendered to the warehouseman and canceled by him before the products may be delivered. Receipts issued under the U.S. Warehouse Act are supported by inspection and/or weight certificates issued by warehouse inspectors and weighers licensed under the Act. Integrity of the warehouse receipt must be maintained if warehouse receipts are to fulfill their role in the marketing system. Integrity means that the original depositor or a subsequent holder of a receipt must have reasonable assurance that the product represented by the receipt will be returned upon surrender and a valid request for delivery.

Each licensed warehouseman is required to post a tariff or a schedule of charges setting forth the amount he charges for receiving, delivering, storing, insuring, conditioning, and all other warehousing services. Copies must be furnished to USDA and cannot be accepted if exorbitant or discriminatory. Before making any changes in rates, amended tariffs must be submitted to USDA.

The U.S. Warehouse Act is administered mainly through programs of comprehensive warehouse examinations--about twice each year on an unannounced basis. Examiners review the warehouseman's obligations to depositors as represented by outstanding warehouse receipts, scale tickets, and accounts. They inventory all commodities on hand, comparing this to the record of obligations. They also review a warehouseman's recordkeeping, housekeeping practices, sanitation, insurance coverage, and check the quality of the product in store. When minor discrepancies or adverse conditions are found, warehousemen are required to bring operations into compliance. When considered serious, the warehouseman's license may be suspended. The Act provides for penalties of up to 10 years in prison and up to a \$10,000 fine for improprieties in connection with warehouse receipts or inspections and weighings.

The Act, as written, was broad in concept and coverage. This has made it possible to keep its regulations responsive to changing situations and demands. For more than half a century, Federal warehouse receipts have continued to play a vital role in agricultural commodity warehousing and financing, two vital ingredients in the marketing process.

I. Introduction:

Some quickly point to revision of the federal bankruptcy laws as an easy answer to the difficulties created by commodity warehouse bankruptcies. It is true some of those problems are in part the consequence of the application of bankruptcy laws to bankrupt commodity warehouses. At the same time, it is important to remember that the bankruptcy laws are not the cause of elevator bankruptcies and that revision of those laws will not prevent elevator bankruptcies. The bankruptcy laws are not the cause of the fundamental problem. To the contrary, they are intended to be the solution to it.

More specifically, modern bankruptcy laws have been described as "a solution to the problem of interpreting and giving effect to the debtor-creditor relationship when the performance that was originally intended by or expected of the debtor becomes impossible because of excess debt. The basis for this solution is a taking of all the debtor's property and property interests and their distribution in satisfaction of debts."

The Federal government could have left resolution of the question of what to do when someone cannot pay their debts to the several states. However, the Constitution grants the Federal government specific authority to establish uniform laws governing bankruptcy, and there have been such laws since the beginning of the nineteenth century. Modern bankruptcy law dates from the enactment of the Bankruptcy Act of 1898, through its first major overhaul in 1938 by the "Chandler Act", to its most recent amendments by the Bankruptcy Code of 1978 which became effective on October 1, 1979.

The 1978 amendments represent a comprehensive revision and reform of the substantive law of bankruptcy as well as practice and procedure. In addition to being the first major look at bankruptcy in 40 years, the new Act was the result of 2,700 pages of testimony dating back to its original drafts in 1973. Indeed, when H.R. 8200 was signed by the President on November 6, 1978, over eight years of work by a congressional commission, congressional committees and subcommittees, and such diverse sources as the Brookings Institution, the American Enterprise Institute, and the National Bankruptcy Conference was completed. Changing the bankruptcy laws to solve problems created by grain elevator bankruptcies therefore involves amending a body of law that has recently undergone extensive review and revision.

* Paper included in the preliminary findings reported by USDA's Elevator Task Force Working Group to an Ad Hoc committee of industry representatives on May 12, 1981. It is not intended to offer recommendations for change but to provide background for amending the bankruptcy law.

II. Rights of Producers Who Have Delivered Commodities to a Bankrupt Warehouse

The proposals that have been advanced for the revision of the bankruptcy laws as they apply to commodity warehouses have been principally concerned with the protection of the producers of commodities.

Many different kinds of transactions can take place between a producer and a warehouse in connection with the delivery of a commodity to the warehouse but, fundamentally, in all these transactions, the producer becomes either a bailor or a creditor. He becomes a bailor when a commodity is delivered to a warehouse for storage, processing, or other handling but title remains with the party that delivered the commodity or some third party. Bailment is the legal term that describes such an arrangement. The warehouse is a bailee, and the owner is a bailor. A bailment exists when a commodity is delivered for simple storage; for storage, handling and delivery to a purchasing third party, either immediately or some time in the future; or for sale by the warehouse on behalf of the owner. A producer becomes a creditor when a commodity is delivered to a warehouse and sold to it with payment to be completed at some future time.

When a warehouse becomes bankrupt, a producer who is a bailor has a right to receive the commodity which he placed in storage or its value, regardless of the extent or number of the claims of creditors of the warehouse. Two problems have arisen with respect to this clear right of producers who are bailors. First, sometimes there are insufficient commodities in the warehouse to meet all the claims of the bailors. In some instances this problem is exacerbated by the fact that the bailors must share the commodities with any creditors of the warehouse who received a document of title to grain in the warehouse, owned by the warehouse, as collateral for credit extended to the warehouse. In theory, a warehouse should always contain enough commodities to meet all obligations to bailors and all creditors to whom commodities owned by the warehouse have been pledged as collateral. In practice, this is usually not the case when an elevator goes bankrupt.

Second, it sometimes takes a producer who is a bailor a long time, perhaps months or even years, to get even a portion of his grain or its value when the warehouse in which he has stored it is in bankruptcy.

When a warehouse becomes bankrupt, a producer who is a creditor of the warehouse has the right to have his claim settled out of the estate of the warehouse. The problem is that

the producer must share the assets of the estate with other creditors and there are seldom enough assets to pay all claims in full. Further, this claims settlement process can take a long time, sometimes years.

III. Proposed Changes in Bankruptcy Laws

Several proposals have been advanced during the current session of Congress (97th Congress, 1st Session) to amend the United States Bankruptcy Code (Title 11, United States Code) to address these problems.

Congressman Bailey's bill, not yet introduced, removes stored agricultural products from the automatic stay provision of the Act. It should be noted that, under the current law, most courts, in order to protect their jurisdiction, would issue a specific stay. A judicial or administrative hearing for a determination of interest would still be required and any State court proceeding would lack jurisdiction over CCC. The bill also adds a superfluous clause to warehouse receipts which simply restates the present law.

Congressman Glickman's bill (H.R. 2593) and Congressman Coleman's bill (H.R. 2582) would only require that the court give priority to any request for relief from a stay. At present, this is required by the code for all requests for relief. If relief is allowed, it would only apply to the requestors, and the due process requirements of determination of interest referred to in the bills would still need to be completed.

Senator Dole's bill (S. 839) sets out specific timetables for certain actions on the part of the court. The Dole bill also affects the Negotiability of Warehouse Receipts, interferes with the priorities set by State Law, relegates CCC and financial institutions to inferior positions, and sets up a priority position for producers who have sold their grain to warehousemen.

Any amendment of the United States Bankruptcy Code in an attempt to place producers in a more favorable position in commodity warehouse bankruptcy proceedings would carve out a special exception for such producers and treat them much differently than any other bailor or creditor in other types of bankruptcy proceedings. Due process requires that certain steps be taken in the dispersal of property under the control of any court, including the bankruptcy court. This is mandatory and any shortcutting of the due process requirement could cause injury to the very parties the solution is attempting to protect.

State Requirements of Warehousemen for Bonding and/or Insurance

<u>Financial Statement</u>	<u>State</u>	<u>Bond Required</u>	<u>Insurance Required</u>
Yes	Alabama	Yes, surety type, minimum \$5,000, can require increases when public interest demands. Maximum bond decided by Commissioner of Agriculture.	Yes, on cotton, by fire, in full.
No	Arizona	No	No
Yes	Arkansas	Yes, surety type, minimum \$20,000. 20 cents per bushel for 1st million--15 cents/bu. for 2nd million and 10 cents/bu. over 2 million.	Yes. Full market value for fire, explosion, lightning, and windstorm.
No	California	Yes, for beans, performance type.	No
No	Colorado	Moot	Yes, can be substituted by proof of financial responsibility. Insurance amount set by Commissioner.
No	Delaware	No	No
No	Florida	No	No
Yes	Georgia	Yes, surety type, amount based on warehouse capacity, minimum \$5,000, maximum \$100,000. Exact bond amount decided by Commissioner.	Yes, full market value for fire, lightning, and extended coverage. Cotton fully insured for fire and lightning only. Producer may waive this insurance requirement.
No	Idaho	Yes, surety type, minimum \$10,000, maximum \$500,000. 6% of value of commodity.	Yes, full market value.
Yes	Illinois	Yes, surety type, minimum \$10,000, 15 cents per bushel of total capacity.	Yes. Full market value hazard insurance.

State Requirements of Warehousemen

<u>Financial Statement</u>	<u>State</u>	<u>Bond Required</u>	<u>Insurance Required</u>
Yes. \$10,000 Net Worth.	Indiana	Yes, performance type, minimum \$5,000, maximum \$100,000. 25 cents/ bu. first 100,000; 15 cents/bu. for 2nd 100,000; 10 cents/bu. over 200,000.	Yes, full market value. Hazard insurance.
Yes	Iowa	Yes, performance type, amount depends upon type and amount of commodities.	Yes, for current market value. Hazard insurance.
Yes. Net Worth equal to 10 cents per bu. of stge. capacity not to exceed \$100,000.	Kansas	Yes, surety type, minimum \$10,000, capacity times first Monday in April KC cash price per bushel minus 25 cents.	Yes, full market value.
No	Kentucky	Yes, surety type, minimum \$10,000, quantity of grain stored times factors set by State.	Yes, for all grain stored at value thereof.
Yes	Louisiana	Yes, surety type, minimum \$5,000 amount based on value of the unit of measure times the capacity. This does not apply to cotton. Cotton: net assets minimum \$15,000, maximum \$75,000, and bond at \$5 per bale times capacity.	Yes, full value, except on cotton.
No	Maine	No	No
No	Maryland	No	No
Yes	Michigan	Yes, surety type, \$15,000 plus \$5,000 for each additional 10,000 bushels of capacity.	Yes, full market value. Hazard.
No	Minnesota	Yes, surety type, amount set by State. \$1,500 minimum.	Yes, full market value. Hazard.
Yes	Mississippi	Yes, surety type, amount set by Mississippi Commissioner of Agriculture and Commerce.	Yes, full market value. Hazard.

State Requirements of Warehousemen

<u>Financial Statement</u>	<u>State</u>	<u>Bond Required</u>	<u>Insurance Required</u>
Yes	Missouri	Yes, surety type, minimum \$10,000, capacity times factor based on commodity stored.	Yes, full market value.
No	Montana	Yes, surety type, minimum \$15,000, amount set by Montana Department of Agriculture.	Yes
Yes	Nebraska	Yes, surety type, minimum \$1,000 amount set by Nebraska Public Service Commission.	Yes, total value.
No	New Mexico	Yes, surety type, \$5,000.	Yes, total value.
Yes	New York	No	No
No	North Carolina	No	No
No	North Dakota	Surety bond. \$50,000 minimum.	Yes
Yes	Ohio	Bond required for net worth deficiency.	Yes, full market value.
Yes	Oklahoma	Yes, surety type, minimum \$20,000 based on capacity, maximum \$500,000.	Yes, full market value.
No	Oregon	Yes, surety type, minimum \$5,000, maximum \$200,000.	Yes, current.
No	Pennsylvania	No	No
No	South Carolina	Moot	Yes, full value.
No	South Dakota	Yes, surety type, minimum \$5,000 up to 10,000 bushels, plus \$3,000 for each additional 10,000 bushels. When value of property held exceeds bond amount, bond must be increased to cover value of property.	Yes, fully insured, except CCC grain.
No	Tennessee	No	No

State Requirements of Warehousemen

<u>Financial Statement</u>	<u>State</u>	<u>Bond Required</u>	<u>Insurance Required</u>
No	Texas	Yes, surety type, minimum \$15,000, maximum \$500,000.	Yes, full market value.
No	Virginia	Yes, surety type, minimum \$1,000, maximum \$20,000.	Moot
No	Utah	?	?
Yes	Washington	Yes, surety type, minimum \$25,000, maximum \$500,000.	Yes, fully insured, current market value.
Yes	Wisconsin	Yes, surety type, \$5,000-\$25,000.	Legal liability insurance can be purchased in lieu of bond.
Yes	Wyoming	Yes, surety type, minimum \$15,000, exact amount based on warehouse capacity.	Yes, full value.

Possible Options For a Remedial Program

The following options were developed from preliminary findings by the USDA elevator task force working group along with papers related to the task force study submitted by interested industry officials and other individuals. These options are not intended to offer recommendations for change but to provide background information on the related issues.

Summary

Three primary options are outlined to operate an examination program for grain storage and purchasing.

All Federal Program:

The main proposal is for a comprehensive mandatory Federal grain storage-grain purchasing statute. It calls for licensing warehouses, surety bonding of licenses to afford a measure of protection to storers and producers-sellers of grain, and an indemnity fund to further protect producers of grain not fully protected by surety bond. The law would be administered by the Secretary of Agriculture with Federal employees.

Funding would be obtained from fees assessed to the storer-buyer covering costs of licensing and administration while producers would contribute to a check-off system for the indemnity fund and its administration.

Federal-State Program:

- (1) Federal program with examination function contracted to States.

Alternate proposal "1", by changing Section IX, would provide that the Secretary could contract with various States for the examination program. Federal examination activities then would be limited to a monitoring of the State's activities in this area, and the system would essentially become a Federal-State effort.

- (2) State program meeting Federal guidelines.

Alternate proposal "2", by changing Section IX, would provide that the Secretary could determine that if a State had licensing, bonding, and examination requirements at least equal to requirements of the Act, storers and dealers in that State would be subject to State, and not Federal, regulation. The Federal position then would be only to determine that States meet Federal guidelines. The indemnity fund and its administration could be totally Federal and part State or totally State.

All State Program:

States would be encouraged to adopt a "model" law and at the same time meet the special needs of each individual State.

Elements of a Mandatory Federal Grain Storage and Merchandising Law

All Federal Program

1. Introduction: This approach would require a Federal statute providing for mandatory compliance by all persons who store grain for anyone and/or buy grain from producers. Such persons would be licensed to perform such services in accordance with requirements of the Act and regulations issued thereunder. The Secretary of Agriculture would administer the Act.

The purpose of the Act would be to establish a sound system for storing, selling, and insuring payment for producer originated grain. The Act would apply to grains as determined by the Secretary. The Act would offer limited protection through surety bonding of the licensees for all persons engaging in storage transactions and producers engaging in storage and selling transactions. The storage and selling transactions of producers could be secured to a further extent through an indemnity fund or insurance program.
2. Requirements for Licensing: Parties making application for licensing would need to:
 - (1) Legally be in the business of buying and/or storing grain and have suitable fixed facilities for the receiving and handling of grain.
 - (2) Have and maintain at all times a financial condition, as required. Failure to maintain such a condition would render the licensee subject to license suspension or revocation.
 - (3) Have reputable, experienced, and competent management.
 - (4) Have a bond or bonds to secure the faithful performance of obligations as a storer and/or buyer of grain in such amount as may be determined by the Secretary.
 - (5) Keep accounts, records, and memoranda that fully and correctly disclose all transactions involving the business, including the true ownership of the business by stockholding or otherwise. Whenever the Secretary finds that such accounts, records, and memoranda do not fully and correctly disclose all transactions involved in the business, the Secretary may prescribe the manner in which they shall be kept.
 - (6) Make reports to the Secretary concerning the business in such form and at such times as the Secretary may require.
 - (7) Observe sound warehousing and merchandising practices, including protection of all over-sold and/or over-purchased positions (hedging).

(8) Have and maintain such insurance and fidelity bond coverage as the Secretary may deem necessary.

(9) Observe any other requirements the Secretary may deem necessary.

3. Exemptions: The law could exempt persons buying less than \$50,000 of cash grain a year or paying cash or the equivalent thereof for grain purchased. However, persons buying on deferred pricing or payment contracts would not be exempted.

4. Bankruptcies: In the event of a bankruptcy or other failure to pay, the law would provide for the licensee's grain inventories (other than those required to satisfy storage obligations) and grain receivables, and the licensee's proceeds from grain, grain feeds, or grain products to be held in trust. This would ensure that all persons receive full payment for storage obligations, and that producers are paid for grain sold to the licensee for which payment had not been made. If a bankruptcy should occur, these persons and producers would be paid before other creditors.

5. Availability of Funds to Meet Grain Payables: Persons operating licensed facilities would need to have available funds and/or resources to meet commitments to producers for grain delivered and for which the producer had not been paid. This could be accomplished by:

(1) a segregation of such funds as were due from sales of unpaid producer grain or uncommitted bank deposits from sales, or

(2) maintaining an inventory at the licensed facilities or elsewhere of like quantities of unencumbered grain, or

(3) a combination of (1) and (2).

6. Indemnity Fund: In addition to the bond(s) required in III (4), a fund could be established by the Secretary known as the USDA Grain Indemnity Fund, which could be available to indemnify producers who through storage or selling transactions with licensees under the Act were not fully compensated for their products. The fund in the initial amount of \$_____ could be established by appropriation or by borrowing from Commodity Credit Corporation as the Secretary determines. It would be maintained at \$_____ through assessments to the producers being indemnified. An assessment rate for the indemnity fund would be determined yearly by the Secretary; such rate to be based on what would be required to maintain the fund.

- Note: In lieu of surety bonding, the use of the fund for all bonded losses could be considered with an assessment to warehousemen equal to normal bond costs. Producers would continue to pay into the fund.
- In lieu of a fund, the use of legal liability insurance provided by a private insurance company or an underwriting group which would have limits at each individual warehouse in excess of present bonding requirements could be considered. There would be an assessment to warehousemen equal to cost but relative to normal bond costs.
- A single line of protection could be available or a "mix" of surety bonding, indemnity fund, or legal liability policy could be considered.
7. Protection Under the Act
- (1) For persons, other than producers, storage obligations including collateral receipts would be protected to the extent of the applicable surety bond portion.
 - (2) For producers, storage and sales obligations to the extent of the applicable surety bond portions plus access to the fund and its limits. (Producers would subrogate claims against grain, warehouseman's assets, and surety bond to USDA Grain Indemnity Fund).
 - (3) Monetary recovery by any one producer from any one facility for any one grain could be limited to 100 percent for losses not exceeding \$50,000; a maximum of \$50,000 for losses \$50,000 to \$100,000; and 50 percent of any loss exceeding \$100,000, with a maximum of \$100,000.
8. Referral to Courts
- USDA, in its own right, would have authority to take over a failing or failed operation. The Department would distribute to rightful owners the grain that is subject to a bailment, conserve funds from excess warehouse owned grain and other funds set aside for the benefit of producers, or seek a court appointed conservator for this purpose.
9. Examinations
- The Act would preempt all present Federal and State laws on grain warehousing and merchandising. The Secretary of Agriculture would be authorized to examine all warehouses and the contents therein and all books, records, papers, and accounts of persons licensed under the Act. Such warehouses and equipment would be maintained in a condition as deemed necessary by the Secretary to avoid undue risk and hazards to the Secretary's agents.

10. Fees Fees would be assessed to the storer-buyer for licensing and administration services while the cost of the examination program and the administration of the indemnity fund would be recovered from the indemnity fund.

11. Penalties Any new law should consider the deterrent effect of additional and more severe penalties for actions which would tend to increase the possibility of losses. With an indemnity fund, operators may become careless as depositors would appear to have protection, and the warehouseman might not have to face angry depositors in the community.

Federal-State Program

Alternate 1 All sections of the All Federal Program would apply as stated except the following:

9. Examinations and Cooperation with States The Act would preempt all present Federal and State laws on grain warehousing and merchandising.

The Secretary of Agriculture would be authorized to examine all warehouses and the contents therein and all books, records, papers, and accounts of persons licensed under the Act. Such warehouses and equipment would be maintained in a condition as deemed necessary by the Secretary to avoid undue risk and hazards to the Secretary's agents.

Subject to supervision by the Secretary, the Secretary could authorize and contract with any qualified State agency to perform the examinations required under the Act; such examinations to be conducted as instructed by the Secretary.

Alternate 2 All sections of the main proposal remain as stated, except the following:

9. Examinations and Cooperation with States
- (1) The Secretary of Agriculture would be authorized to examine all warehouses and the contents therein and all books, records, papers, and accounts of persons licensed under the Act. Such warehouses and equipment would be maintained in a condition as deemed necessary by the Secretary to avoid undue risk and hazards to the Secretary's agents, or
 - (2) Whenever the Secretary determines that any State has authority for and has developed grain storage and dealer

licensing, bonding, administrative, and examination requirements with respect to operations and transactions within such State at least equal to those imposed under applicable sections of this Act, and can and will enforce such requirements, then licensing under the Act. Should a State be determined by the Secretary as meeting the foregoing requirements and on a subsequent determination be found not to have or not to be effectively enforcing such requirements, storers and buyers in that State shall no longer be exempted from provisions of this Act. Monitoring of the States to assure compliance with Federal requirements would be established.

All State Program

Over the years, the Association of the American Warehouse Control Officials, through committee action, has sought to develop a model law based on the experience of States that have had regulation in this area.

The first effort covered the storage of grain only. A later one addressed the grain dealer problem. A more recent proposal combined both plus and indemnity feature.

The States should be encouraged to improve model laws in the light of the task force conclusions, and to adopt a "model" law that also meets special needs of the individual State. Such a law would be similar to a Uniform Commercial Code.

The outline for the Federal Comprehensive Law or the standards for State law could serve as a "check list" in developing such a model.

Possible Options For a Remedial Program Advantages and Disadvantages

All Federal Program

Advantages:

Offers a nationwide, uniform, straight line administration program affording considerable protection to producers for storing and selling activities while retaining traditional storage protection for all depositors, but does not over-regulate.

Eliminates dual Federal-State regulation and duplication of effort. One agency to regulate.

Provides priority claims for producers against grain and/or proceeds therefrom.

Enables the Secretary to act for producers.

Results in less cost than a fragmented program considering added protection, and savings from Federal only, rather than Federal and State, licensing, bonding, and examination programs.

Disadvantages:

Creates a new and large Federal agency.

Results in a high-cost Federal check-off system paid for primarily by producers.

Preempts State jurisdiction and nullifies many State prerogatives.

Invites a level of controversy that could delay or impair an effective program.

Federal-State Program

Alternate 1

Advantages:

Offers most of the advantages of the All Federal Program.

Enables States to contract with the Federal government for use of employees whose jobs would be eliminated under the All Federal Program.

Disadvantages:

Requires auditing and monitoring of State contracts and payments.

Creates a new, large, and costly Federal agency. Requires a check-off system that producers do not like.

Alternate 2

- Advantages:
- Offers a National system based on adequate minimum Federal standards.
 - Affords opportunity for proven State systems to continue present activities under Federal minimum guidelines, and would be more acceptable to States.
 - Makes available expertise of Federal and State personnel.
- Disadvantages:
- Creates new, costly Federal agency somewhat dictating to States.
 - Requires check-off system.
 - Results in somewhat divided authority between Federal and State governments.
 - Requires Federal auditing and monitoring of State requirements and enforcement procedures.
 - Results in loss of "National" system of warehouse receipts.

All State Program

- Advantages:
- Leaves to individual State the type of protection it will offer.
- Disadvantages:
- Results in various programs -- some good, some bad; offers no assurance of adequate programs.

Possible Administrative and Legislative
Changes Under the Existing Preventive Program
United States Warehouse Act

Introduction:

The U.S. Warehouse Act is a voluntary law that provides for the licensing of warehousemen who apply to the Secretary of Agriculture, and (1) meet departmental standards, (2) agree to abide by the law and regulations, and (3) are, in the Secretary's discretion, proper warehousemen within the intent of the law for the storage of agricultural products.

The primary objectives of the U.S. Warehouse Act are to: (1) protect producers and others, including the Commodity Credit Corporation, who store their agricultural products in public warehouses, (2) assure the integrity of warehouse receipts as documents of title to be used as collateral for loans and to facilitate trading of agricultural commodities in interstate commerce, and (3) set and maintain a standard for sound warehouse operations.

The program is based on financial, bonding, licensing, and administrative requirements with comprehensive examinations.

Since January 1, 1979, USDA has had 8 licensed warehouses reported to have declared voluntary or involuntary bankruptcy. Some of these cases remain unsettled at this time. We know of no confirmed losses to Federal receipt holders, but this does not mean that there will not be such losses, or that if there are such losses, there will be sufficient surety bond to make restoration. The surety bond under the U.S. Warehouse Act supports obligations only of a storage (bushels) nature; merchandising (dollar) obligations are not protected. Of the 8 cases, 5 are in Illinois and Indiana. In Illinois and Indiana, merchandising obligations at Federally licensed warehouses have been under the protection of State law. Losses to producers storing with licensed warehouses have been minimal over the past 60 years. All have been covered by bond to the present.

Possible Actions:

Some actions which USDA could take to further enhance protection for producers are:

- (1) **Marketing Activities:** In the last several years, the risks for producers in dealing with grain warehouses have shifted from the storage to the marketing operation. Almost all elevators which store grain also buy grain. The use of Delayed Price and Deferred Payment contracts has lessened the amounts of grain stored and increased grain payable accounts contributing to this high loss risk. The business of storing and marketing cannot be segregated. These situations create continuous, dual, and at times, uncertain obligations. USDA has

considered for some time regulations which would offer some protection to users of Federally licensed warehouses who deposit their grain for other than storage purposes. These regulations are not extensive requirements across the industry. The requirements will be minimum and tailored to the individual warehouseman. They are aimed at extending the use of good business practices. When these regulations are in effect, a measure of protection is afforded to users of Federally licensed warehouses who deposit their grain for marketing as well as those who deposit for storage.

- (2) **Assets and Bonding:** A sound warehouse operation must originate from a sound financial base, and depositors in licensed warehouses must be assured that they will have some financial protection if a warehouseman's financial base worsens. Based on experience, moderate increases in asset and bonding protection for storage customers are advisable, but the immediate need is in the merchandising area. The regulations described in No. 1 above provide for such needs. It has been suggested that the bonding protection under the Act be supplemented by an indemnity fund or legal liability policy issued by a private sector insurance or underwriting agency. This would require legislation.
- (3) **Financial Information:** It has been suggested that the furnishing of an unqualified CPA statement should be the basis for licensing and/or continuation of license.
- (4) **USDA Role in Potential Bankruptcies:** Another possibility is that USDA take a more active role in pursuing a depositor's interest in a warehouse that appears destined for bankruptcy or that has declared bankruptcy.
- (5) **Penalties for Violations of the Act:** It has been proposed that penalties be increased for violations of regulatory acts that may defraud or monetarily damage others. This would act as a deterrent to willful acts.
- (6) **User Fees and the Act:** The FY 1982 budget for the Department proposes that all costs of operating the U.S. Warehouse Act program be funded by user fee assessments. Heretofore, the Act has been funded entirely by appropriation.

- (7) Federal-State Relations: In States having mandatory grain warehouse laws, warehousemen may elect to be licensed under the U.S. Warehouse Act and thus become exempt from State regulation.
- (8) Information.
- (9) Clearinghouse.

These possible actions will be discussed in detail in the attachments.

Marketing Activities:

In the last several years, the risks for producers in dealing with grain warehouses have shifted from the storage to the marketing operation. Almost all elevators which store grain also buy grain.

The use of Delayed Price and Deferred Payment contracts has lessened the amounts of grain stored and increased grain payable accounts contributing to this high loss risk. The use of these contracts results in "dollar" obligations (purchased grain not paid for) as opposed to "bushels" obligations (stored grain to be delivered on demand). Documentation of such contracts of purchase is important on the part of the buyer to place the transaction in a "dollar" obligation to relieve buyer of the necessity of retaining in storage bushels of the kind, quality, and quantity delivered.

The Department has had under consideration for some time regulations which offer some protection to users of Federally licensed warehouses who deposit their grain for other than storage purposes. Regulations under consideration define the various storing and marketing transactions which are essential to the operation of a licensed grain warehouse. They further provide for bonding to support such transactions as a warehouseman may have for the marketing, handling and shipping of producer-owned grain other than as storage. Additional bonding for marketing transactions is required at the rate of 10 cents per bushel of licensed capacity with a minimum of \$25,000 and a maximum of \$250,000 required. The increased bonding is solely for the benefit of producers. The amount is one-half that to be required for warehousing (20 cents per bushel with a minimum of \$25,000 and a maximum of \$500,000). Protection already in effect for storage customers must be maintained, but the bond for marketing (where the greater risk to producers is) should be more than that for storage. Bonds for marketing are extremely difficult to obtain and are costly (\$10 per \$1,000). The "slack" must be taken up in added admin-

istrative and supervisory requirements such as frequency of examinations and extended scope of such examinations which may include additional financial reporting requirements.

Advantages:

Grain received into a federally licensed warehouse as the result of like contracts is mixed with grain for which the warehouseman has a storage liability under the Act. When such grain is sold, it is loaded from similar stocks which results in a mixed liability in a common mass. Some of the gain is a "bushel" obligation; the balance may be a "dollar" obligation. The grain cannot be separated, so the warehouseman's true and total obligation (bushel and dollar) position and coverage must be determined.

The mixture of stocks creates continuous, dual, and, at times, uncertain obligations. A sound warehouse operation must originate from a sound financial base, and depositors in licensed warehouses must be assured that they will have some financial protection if a warehouseman's financial base worsens. The business area most likely to affect a warehouseman's financial stability is the marketing area. Supervision here will enhance deposition protection.

By exercising jurisdiction in the market area, the Federal Act will replace State regulation and end "duplication" of examining by both Federal and State agencies. Warehousemen will have only one agency's regulations to follow.

Disadvantages:

The Department is entering an area formerly supervised by some States with mandatory programs.

Licensed warehousemen will need to have additional bond at an increased cost.

Assets and
Bonding:

This is seen as a means to better protect depositors in licensed warehouses. Consequently, the Department frequently reviews its requirements. Recently, it was concluded that moderate increases in net asset and bonding requirements should be recommended to enhance the security offered by licensed grain warehousemen to depositors. This will require amending the regulations. Since a proposal was underway to amend the regulations for grain warehouses to define the various storing and marketing transactions conducted in a licensed grain warehouse, it seemed appropriate to also include moderate increases in net asset and bonding requirements.

Accordingly,

- (1) the minimum allowable net asset requirement of \$10,000 was increased to \$25,000.
- (2) the rate for bonding was changed from a graduated scale of 20 cents per bushel for the first 1,000,000 bushels of licensed capacity, 15 cents per bushel for the next 1,000,000 bushels, and 10 cents per bushel for any capacity over 2,000,000 bushels to a straight 20 cents per bushel of licensed capacity, and (3) the minimum amount of bond required was increased from \$20,000 to \$25,000.

No change was made in the requirement for warehousemen to have and maintain a net asset position amounting to 20 cents per bushel of licensed capacity and a maximum bond of \$500,000.

These changes pertain only to the protection of storage (bushels) obligations. Additional bonding is being required of warehousemen who contract with producers for services other than storing, but this is a new requirement.

Advantages:

The holder of a storage obligation has several lines of protection. First, the grain represented and which should be in storage when a problem arises; second, the financial condition of the warehouseman which comes into play if the grain is not intact; and finally, if the grain is not sufficient in kind and grade and there is a lack of monetary assets, the warehouseman's bond. As to the grain, the holder is a preferred creditor having title to a pro rata share of the remaining kind of grain the obligation represents. As to the excess of monetary assets over monetary liabilities, the holder shares as a common creditor, and the warehouseman's bond is available to those people who can prove a storage obligation on the part of the warehouseman. The extent of asset and bonding requirements becomes very important when protective lines 1 and 2 are not sufficient.

Historically, USDA asset and bonding requirements have been sufficient to protect most depositors; at this time, there are no known losses not covered by bond. There are some unsettled cases which could result in such losses. The Department relies heavily on its pre- and post-licensing examinations as an alert to problem situations. The posture is preventive rather than remedial.

Some States have so-called "unlimited" bonding and others "100 percent" bonding. "Unlimited" bonding generally means there is no maximum; i.e., Iowa has a minimum of \$6,000 and increases starting at 50 cents per bushel, dropping to 20 cents per bushel of licensed capacity over 75,000 bushels with no maximum. South Dakota has "100 percent" bonding (\$5,000 for the first 10,000 bushels and \$3,000 for each additional 10,000 bushels), but this is based on reporting by the warehouseman of grain for which warehouse receipts have been issued (not computed on licensed capacity).

An effective effort by regulatory agencies should be a balance of financial requirements and reporting, bonding, and administration of an adequate law.

Disadvantages: Bonds are costly and somewhat difficult to obtain.

Financial Information: It has been suggested that the furnishing of an unqualified CPA statement should be the basis for licensing and/or continuation of license.

Advantages: The unqualified CPA statement is a good working tool for management and regulatory personnel when it contains an operating statement, a verification of claimed inventory, a confirmation of storage (grain) obligation, and accounts for grain payables, bank loans, and a market position.

The CPA audit reveals items easily ignored, overlooked, or hidden by company accountants, usually the result of mediocre and/or uncontrolled records.

The Department uses the CPA statement as a general guideline. Area offices are advised that when the unannounced examination goal is in jeopardy to give priority to examining warehouses not furnishing such statements.

Fewer and less frequent post-licensing examinations could be scheduled.

Entry of the Department into regulation of the grain marketing activities may prompt a re-evaluation of its policy.

Disadvantages: Even with a CPA statement, the warehouseman may ignore financial danger signals if they are not sufficient to warrant action by regulatory officials.

While such statements are necessary to a good program and can partially offset the need for a second examination, there are difficulties in assessing the cost-effectiveness of such a requirement. First, it would add about \$3,000 to \$5,000 to the yearly cost of licensing for warehousemen. Some smaller well-run businesses performing a needed service in the community might have problems meeting this requirement.

The CPA statement cannot wholly take the place of an unannounced subsequent examination. It is not as timely as other statements, and scheduling an examination 6 months or so from the date of the statement becomes a scheduling problem. The absence of the second examination could dilute the credibility of the examination program. It would not save money proportionately to its omission, i.e., one examination a year would not cost half as much as two examinations per year.

Detection of fraud is not a major objective of the CPA audit.

USDA Role in
Potential
Bankruptcies:

Historically, the Department, under the U.S. Warehouse Act, had not taken an active role in pursuing depositors' interest in a warehouse that appears destined for bankruptcy or one that has declared bankruptcy. Depositors have been informed of their rights and advised to seek legal counsel. Accordingly, there is a question as to what procedures could be invoked and what kind of authority would be needed to carry out those actions.

Present Authority:

Sections 12 and 25 are suspension techniques available to the Secretary to enforce the U.S. Warehouse Act, while Section 30 defines penalties for those persons who violate principles of operations prescribed under the Act. Sections 12 and 25 provide for suspension and revocation of licenses after opportunity for hearing, when licensees violate specified provisions of the Act and for temporary suspension of such licenses without hearing pending investigation. Section 25 deals with situations discussed in this memorandum. The usual procedure is: (1) a risky or illegal situation is discovered; and (2) a notice of temporary suspension noting matter to be investigated is issued to the licensee, including a request that all licenses and other official forms be returned. The major force of such a suspension is to prevent the warehouseman from incurring additional obligations while making an effort to correct the conditions which resulted in the suspension. Suspension does

not prevent a warehouseman from continuing operations, it means that such operations are not sanctioned as a licensed warehouseman. The majority of suspended licenses are reinstated upon application, payment of fee, and proof of correction of deficiencies. Most of the other suspensions result in termination when the warehouseman fails to furnish a new bond necessary to continuation of license. Seldom is a hearing requested. When deficiencies are not corrected promptly and a license continues in a suspended state, there appears to be a "void" in the regulatory process. Conditions can worsen during a period of suspension. Possibly, some prompt actions in various areas of the warehouseman's operation could prevent or lessen losses for depositors and customers of the warehouse.

Authority Being
Considered:

The Department and the Office of General Counsel are reviewing actions USDA might take when licensed warehousemen are considered in danger of, or are actually in bankruptcy. These actions would assist affected producers and assure that producer-owned commodities in storage or those in which they have an interest are not in jeopardy. Actions being reviewed for authority are for the Department to take action on its own initiative to petition a proper court to bring about the bankruptcy as:

1. (a) To issue a decree that customers of a warehouse are in need of protection, and appoint a trustee to conserve the assets of the business;
- (b) To request of the trustees that all grains in store be held for account of storage claimants and/or grain payables to producers including cash proceeds held or due from others for sale grain;
- (c) To apply for a temporary or permanent injunction restraining any person from violating or continuing to violate any of the provisions of this Act or any rules and regulations promulgated under the Act notwithstanding the existence of other remedies at law;
- (d) To prohibit a grain dealer from disposing of any grain owned, in whole or in part, or held or in the dealer's possession whether owned in whole or in part;
- (e) To prohibit anyone from removing any grain in which the grain dealer or producers from which

the grain has been purchased have an interest, and

- (f) To have authority for the disposition of such grain.
2. If action less than bankruptcy is considered appropriate and temporary suspension of license has taken place, USDA could have authority:
- (a) To close the warehouse to new business during the investigation period;
 - (b) To temporarily suspend a license; schedule and notify the licensee of a hearing and, on the basis of such hearing, to revoke said license;
 - (c) To take possession of the grain stocks for delivery to those persons presenting a valid storage receipt; and
 - (d) Where stocks were not sufficient to satisfy all storage claimants, to sell the grain for the account of claimants and to collect on any bonds in effect to support obligations and to distribute the proceeds pro rata. This latter procedure could be extended to cover grain payables owed producers for grain delivered, sold but not paid for in the event the Secretary exercises jurisdiction over grain merchandising activities of licensed warehousemen.
3. USDA could have the right to file notice of appearance in any proceeding and participate as a party in any court actions affecting licensees.

The main thrust of these actions would be a direct involvement by USDA in the legal process. The Department would endeavor to conserve the grain assets or cash proceeds therefrom for persons who had storage and/or grain payable claims. This would be accomplished either through a trustee appointed by an appropriate court or by the Secretary acting as trustee for the affected parties.

- Advantages: Such actions by the Department would speed up handling of depositor's grain and/or claims affording quicker and fuller recovery by depositors.
- Disadvantages: This procedure could involve more work and risk on the part of the Department.
- Conclusion: First reaction from OGC is that amendments to the Act would be necessary to accomplish these objectives.
- Penalties for Violations of the Act: The idea has been proposed that increased penalties for violations of regulatory acts that have the opportunity of defrauding or monetarily damaging others would be a deterrent to willful acts.
- Advantages: Legislation could provide for fines to be levied by the Department for offenses not serious enough to warrant prosecution.
- The threat of imprisonment is very real to managers. If convictions were easier to come by and sentences toward the maximum were invoked, a stronger deterrent would develop.
- Disadvantages: Penalties under the Act are sufficient for major offenses (conversion, issuance of false or fraudulent receipts, unlawful removal, etc.) The Act provides for penalties of a fine not to exceed \$10,000 or double the value of the products involved if such double value exceeds \$10,000, or imprisonment of not more than 10 years or both at the discretion of the court. Monetary fines are not effective as, generally, there is no money to pay such fines when a bankruptcy occurs. The bankruptcy law does not permit a fine where it would dilute proceeds for the creditors. False sampling, and grading and weighing offenses call for fines not to exceed \$500 and imprisonment of not more than 6 months or both for each offense.
- If penalties under State systems were less severe than under USWA or vice versa, operators would tend to seek licensing to avoid the greater penalty. Generally, penalties called for in State law are less severe than those in the USWA.

User Fees and
The Act:

From the time of its enactment, the U.S. Warehouse Act program has been funded by appropriations; currently, FY 1981 funds are \$3.35 million. It has been suggested that the user fee concept is applicable, and it is proposed in the FY 1982 budget that all costs of the program be assessed against those warehousemen who choose to be licensed.

Advantages:

The Department will no longer need to ask Congress for appropriations to fund this activity, saving the taxpayers' money.

Needs of administration can be translated into amount of fees required and fees adjusted to meet needs.

Grain warehousemen will be encouraged to operate under State law.

Disadvantages:

Prime beneficiaries cannot be reached for user fee assessment and one beneficiary (warehouseman) is being "tapped" for full amount. Anyone who has an interest in the stored product benefits: the producer or other depositor; CCC, banks, or other lending agencies; bonding and insurance companies; warehouseman receives protection under the Act and, consequently, is a beneficiary. Producers could be considered the primary beneficiary if the Act protects their interest in stored products and promotes the orderly handling and marketing of such products. Benefits to marketing system and the Government are making available a system and performing a necessary function or service which is beyond the reach of the persons whose interests are at stake.

A lessened Federal warehouse system could reduce protection to producers and tend to disrupt orderly marketing procedures. The imposition of user fees on warehousemen to cover the entire costs of the program would necessitate fees of such proportion that many warehousemen could elect to drop from the program and those not currently licensed would not apply for licenses. An impaired Federal system would leave many producers and other beneficiaries of the Act in rural areas without the protection previously afforded them. To the extent that warehouses withdraw from licensing under this Act, the acceptance of warehouse receipts as security for trading purposes could be diminished. Federal warehouse receipts are known and acceptable across State lines as there is uniformity of the law, the regulations, and operating procedures.

A significant amount of the grain storage capacity presently under license is the property of cooperatives, owned and controlled by producers. The individual producers store their grain in their "own" facilities. The management uses the Federal receipt and presence in its financing arrangements with appropriate banks

for cooperatives and private financing institutions. The Act serves the cooperative producers not only in their role as depositors but also as part of their warehousing and marketing organizations as well. A diminished Federal system will make necessary changes in these relationships.

Should a number of Federally licensed warehousemen drop out under a fee program, the number of houses requiring examination by the Department would not be reduced, as the Federally licensed warehouses would now need to be examined as CCC contract houses. The net result would be an increase in CCC's administrative funds required to cover the cost of conducting examinations under this program. The ASCS program is quite naturally designed primarily to protect CCC; therefore, a major shift would reduce the benefits of licensing, bonding, and examination policies to the public without materially, if at all, reducing the cost to the Government.

In States with mandatory licensing provisions, there will be an increase in program costs to supervise those warehouses changing from Federal to State.

**Federal-State
Relations:**

A number of States have somewhat similar legislation, but there are many that do not. Some of this legislation is strong, some is not. In States having legislation, the Federal system offers a choice of operation. The statement has been made that the Federal government should focus its attention to the areas where inadequate State legislation and/or enforcement exists.

Advantages:

Some duplication of effort exists where States with grain dealer laws make somewhat similar examinations as the Federal.

A duplication results in unneeded personnel, travel, etc. costs.

A warehouseman then "serves" two masters, the Federal for warehousing, the State for grain dealer activities.

Disadvantages:

The examinations although seemingly alike are for different purposes.

This choice is important in States with strong laws because it encourages improvements in efforts to protect producers in the storing and marketing of their products.

In States without laws it offers safe storage at reasonable rates and the opportunity to convert stored products into a form of collateral for loan purposes.

The primary receiving elevator exercises an important and substantial effect on interstate commerce. It is essential to the promotion and protection of interstate and foreign commerce in the interests of producers, merchandisers, warehousemen, processors, exporters, domestic and foreign buyers and sellers and consumers of grain, and the general prosperity of the nation that an effective system for warehousing of grain be available. The national and multi-national grain trade demands a uniform, recognized warehouse receipt for trading purposes. This choice of operation is important to a viable system.

Conclusion:

This duplication will no longer exist when the Federal exercises jurisdiction in the merchandising (marketing) activities of licensed warehousemen.

Alternative Action by Commodity Credit Corporation (CCC)
To Increase Protection Against Bankruptcies

General:

The CCC has contracts with warehousemen to provide storage for price support commodities. CCC may have title to these commodities or may have a financial interest in these commodities through their use as collateral by producers for a loan from CCC.

The warehousemen and their warehouses must meet CCC's Standards for Approval of Warehouses. Certain requirements of these Standards could be changed which should result in better protection for CCC and other depositors in warehouses under contract with CCC. Possible changes to the Standards would:

- (1) Require that warehousemen file an annual unqualified certified financial statement prepared by an independent Certified Public Accountant (CPA).
- (2) Increase the net worth requirement.
- (3) Require performance bonds.
- (4) Require that all warehouses are either licensed by the U.S. Warehouse Act or by a State which has laws and regulations comparable to the U.S. Warehouse Act as determined by Agricultural Marketing Service (AMS).
- (5) Provide for the acceptance of irrevocable letters of credit in lieu of bonds.

The Standards for Approval may be amended to include any or all of these changes. CCC may find it necessary to accept items 1, 2, and 5 as a means to increase its protection. In addition, CCC may elect to increase the warehouse examination frequency.

Alternative 1:

Amend the warehouse Standards for Approval to require the submission of an unqualified financial statement prepared by an independent CPA. CCC shall require that the statement be accompanied with a recapitulation of grain inventory to obligation. CCC will continue to require at least one warehouse examination per year completed by an AMS warehouse examiner or a State warehouse examiner of a State having a cooperative agreement with AMS.

Comments:

If necessary, CCC will ask assistance from the Office of the Inspector General (OIG) for a special examination to determine what factors are causing a warehouseman's financial condition to deteriorate. This special examination can be requested as a result of a warehouse examination or an analysis of the certified financial statement. CCC may remove the warehouse from the List of Approved Warehouses, if it finds such action will be in the best interest of CCC and other depositors. The use of ratios will continue, such as debt to equity, receivables to payables, current assets to current liabilities, etc., and a system to monitor trends over a period of three or more years to ascertain that the warehouseman's financial condition is not deteriorating. CCC will consult with CPA firms and States that now require certified financial statements to discuss whether the review can be strengthened.

If a warehouseman has a deficiency in net worth as required by the Standards for Approval, CCC will continue to require that a bond or other negotiable security approved by CCC be posted with CCC. The Standards for Approval may be amended to include the acceptancy by CCC of an irrevocable letter of credit.

Advantages:

A certified financial statement:

- (1) Should, if properly analyzed, give an indication of the warehouseman's performance from year to year.
- (2) Should help the warehouseman determine which parts of the operations are efficient and which need improvement.
- (3) Could give an early signal of possible failures of a warehouseman.

Disadvantages:

A certified financial statement:

- (1) Can be costly.
- (2) May cause warehousemen to drop their storage contract(s).
- (3) May, in some cases, be difficult to obtain.

Current Policy:

CCC requires the submission of financial statements annually and at such other times as CCC may require. It may require that the financial statements prepared by a warehouseman or by

a public accountant be examined by an independent CPA in accordance with generally accepted auditing standards.

All financial statements are reviewed by the Warehouse Division of AMS. That office validates the information filed on the statement and determines if the net worth requirements for a storage contract are met.

The ASCS Kansas City Commodity Office (KCCO) is responsible for contract maintenance. If a financial statement is not received in a timely manner, the KCCO will remove the warehouse from the List of Approved Warehouses.

If the warehouseman's net worth meets the amount required on the Standards, no further action is taken regarding the financial statements.

Alternative 2: Increase the net worth requirement by: (a) increasing the basis for computation from 10 to 20 cents per bushel times the capacity; and (b) equaling the maximum storage capacity times the 20 cents per bushel.

Comments: This change would put CCC's requirement on a par with the net worth required by the U.S. Warehouse Act. CCC would continue to enable warehousemen to provide CCC with a bond or other negotiable securities approved by CCC when a deficiency occurs. Warehousemen who do not have a net worth of at least \$25,000 will not be approved.

Advantages: The proposed changes would:

- (1) Have AMS and ASCS following the same procedure to determine net worth.
- (2) Provide increased protection to CCC and producers.
- (3) Make the computation value more in line with increased costs of the commodities.

Disadvantages: The proposed changes could:

- (1) Result in more warehousemen being unable to meet net worth requirements.
- (2) Cause some warehousemen to drop their USDA contracts.

- (3) Raise the storage rates by the added costs of any bonds, etc., that may be required.

Current Policy:

The Standards for Approval now require that all warehousemen have a net worth of at least \$25,000. Warehousemen with capacities exceeding 2.5 million bushels are required to have a net worth of at least \$250,000. Warehousemen with capacities between 250,000 bushels and 2.5 million bushels are required to have a net worth at least equal to the product of the maximum storage capacity multiplied by 10 cents per bushel. (For example, a capacity of 1 million bushels requires a net worth of \$100,000 ($1,000,000 \times .10 = 100,000$.))

The Standards also provide that a deficiency of net worth between \$25,000 and the required amount may be satisfied if the warehouseman furnishes CCC with bonds or acceptable substitute security such as cash, negotiable securities, or a legal liability insurance policy.

Alternative 3:

Require a performance bond of not less than \$20,000 nor more than \$500,000 for each grain storage contract. The amount of bond furnished shall be fixed at 20 cents per bushel for the first one million bushels; 15 cents per bushel for the next one million bushels; and 10 cents per bushel for all capacity exceeding two million bushels. (Same requirements as U.S. Warehouse Act provisions for bonding.)

Comments:

The inclusion of this alternative would be contrary to the recommendations made by the General Accounting Office (GAO) in their report B-114824. The GAO believes that the Federal government has its risks distributed nationwide and should be able to withstand losses that may occur rather than pay to have insurance or bond coverage to protect itself from losses. The level of bond coverage at 20 cents per bushel for a warehouseman having a capacity of one million bushels would equal \$200,000. Under current operating conditions, the emphasis for a warehouseman's operation is on quantity of handle rather than storage. Therefore, a shortage of five percent of a handle of twice the capacity would equal 100,000 bushels. A shortage of this size could have a value of almost double the bond value. Therefore, persons having grain on deposit could have settlements being made at substantially less than the value of their grain.

Advantages:	<p>A performance bond:</p> <ol style="list-style-type: none"> (1) Gives an additional check of the warehouseman's business integrity and operations through verification by the bonding company. (2) Gives additional protection, if the levels of coverage are high enough.
Disadvantages:	<p>A performance bond:</p> <ol style="list-style-type: none"> (1) Would increase costs of storage to all depositors. (2) May not provide adequate coverage if a bankruptcy occurs. (3) Would not have same coverage for all States.
Current Policy:	<p>CCC has not required warehousemen to carry performance or security bonds since 1963. CCC does require net worth deficiency bonds or other approved substitute security if the net worth requirement is not met. CCC neither requires nor carries any liability type insurance. The GAO recommended in 1972 that the government be self-insured against losses. GAO issued a report in 1975 to CCC recommending that CCC discontinue insurance and bonding requirements. CCC discontinued the blanket insurance coverage in 1975. CCC does share, however, in any proceeds from bonds required by Federal or State licensing and warehousing statutes.</p>
Types of Coverage/ Approximate Costs:	<p>Blanket Insurance: The most recent insurance policy had a total limit of liability of \$5 million per year for all locations and a limit of liability of \$250,000 per warehouse location. The policy cost \$576,250 per premium year and was discontinued in 1975.</p> <p>The 1963-64 policy provided for a total limit of liability of \$50 million per year for all locations and a limit of liability of \$2 million per warehouse location. The policy cost \$742,765. This coverage was continued through July 1, 1968.</p>

The following table gives premiums paid and a resumé of payments made by the carrier.

¹ Company	Policy No.	Policy Period	² Premiums Paid	Claims Paid By Carrier	Difference
FEMIC	FE-475	7/1/63-7/1/64	\$ 742,765.00	\$ 534,714.00	\$208,051.00
FEMIC	FE-476	7/1/64-7/1/68	2,038,826.40	3,015,040.00	(976,213.96)
FFIC	MSF-128-28-00	7/1/68-12/1/69	915,062.20	1,015,776.23	(100,714.03)
AIC	30460	12/1/69-12/1/72	1,788,750.00	2,011,911.64	(223,161.64)
AIC	34176	12/1/72-12/1/74	1,152,500.00	336,509.20	815,990.80
TOTALS			\$6,638,903.60	\$6,914,951.43	(\$276,047.83)

¹FEMIC = Farmers Elevator Mutual Insurance Company
 FFIC = Fireman's Fund Insurance Company
 AIC = Appalachian Insurance Company

²Limit of liability reduced from \$50 million aggregate per year and \$2 million per warehouse code to \$5 million aggregate per year and \$250,000 per warehouse code as of 7/1/68.

The CCC billed the warehouseman on a pro rata basis for the cost of the first year's premium. In the succeeding years, CCC reduced the uniform storage rate by an amount sufficient to recover the premium costs. Thus, the CCC had no actual premium costs with the blanket insurance policy.

Performance Bonds:

CCC required performance bonds prior to its obtaining the blanket insurance policy. The amount of coverage required was computed by multiplying the capacity times the value of the principal commodity to be stored times 6 percent. A minimum bond coverage of \$5,000 was required. CCC did not require bond coverage to exceed \$200,000. Bonds required by the U.S. Warehouse Act were accepted in lieu of bonds to CCC. Similarly, bonds required by State licensing authorities were accepted if their coverage met CCC's requirements.

Financial Statements:

CCC requires that a financial statement be furnished annually. If the contracting officer questions the information furnished, the officer may require a certified statement. Many firms already furnish certified financial statements. The cost of a certified financial statement prepared by a CPA may run as high as \$10,000. The State of Illinois currently requires a certified financial statement. Exhibit 2 shows that some States require bonds but not financial statements.

Conclusion:	<p>A blanket insurance policy obtained by CCC would cover only CCC-owned and CCC-loan stocks. The insurance company would probably require that warehousemen meet the Standards for Approval and have a storage agreement with CCC. The coverage would not protect producers or other depositors who do not have a CCC loan on their commodities.</p> <p>The bonding requirements, if required by CCC, would cover only those warehouses licensed by the U.S. Warehouse Act, because it requires bonds, or those warehouses having storage contracts with CCC. Certain States also have the necessary bond requirements that meet CCC's bond requirements. The coverage may be minimal depending on the level of the bonding. CCC could require bonds from warehousemen who have storage contracts with CCC, but CCC could not require licensing authorities to change statutes and regulations to conform to CCC's regulations.</p> <p>One advantage in a bond requirement is that the bonding company would also review the applicant before issuing a bond. A warehouseman's inability to secure a bond would make the warehouseman ineligible for a license or contract.</p> <p>CCC could mandate that warehousemen file current certified financial statements annually. This requirement would not solve the problem of warehousemen not under contract to CCC.</p>
Alternative 4:	Amend the Standards of Approval for CCC storage contracts to require that warehouses be either licensed by the U.S. Warehouse Act or by a State which has laws and regulations comparable to the U.S. Warehouse Act as determined by AMS.
Comments:	All warehousemen and warehouses must meet the Standards for Approval prior to CCC's entering into a contract with the warehouseman. Currently, State laws and regulations vary from being more stringent than what is required by CCC and the U.S. Warehouse Act to no laws or regulations to control warehousing. The Standards for Approval (copy attached) already provide the minimum standards that are required to qualify for a storage contract. Adoption of other alternative changes to the Standards may negate the need for this alternative.
Advantages:	<p>(1) Will result in more uniformity of State laws.</p> <p>(2) Should provide more protection to depositors.</p>

- Disadvantages:
- (1) Will cause a heavy burden on the U.S. Warehouse Act personnel as many States do not have licensing requirements and others will not meet U.S. Warehouse Act standards.
 - (2) Will be exerting Federal intervention in State business.
- Alternative 5:
- Amend the Standards of Approval to provide for the acceptance by CCC of irrevocable letters of credit as a substitute for a bond for warehousemen having a deficiency in their net worth.
- Comments:
- Warehousemen have reported to the KCCO that it is very difficult to obtain bonds to satisfy a deficiency in net worth. In many instances, the bonding companies are requiring the warehouseman to provide financial guarantees such as Certificates of Deposit or a letter of credit before a bond is written. In addition to these requirements, the cost of the bond is high. CCC accepts certain substitute security such as cash, negotiable securities, or a legal liability insurance policy in lieu of a bond. The Standards do not provide for the acceptance of an irrevocable letter of credit.
- Advantages:
- An Irrevocable Letter of Credit:
- (1) Should enable warehousemen to obtain an acceptable substitute security.
 - (2) Should cost less than a bond.
 - (3) Should give CCC more flexibility in accepting substitute security.
- Disadvantages:
- An Irrevocable Letter of Credit:
- (1) May be difficult to obtain by some warehousemen.

UNITED STATES DEPARTMENT OF AGRICULTURE

AGRICULTURAL MARKETING SERVICE

(7 CFR Part 102)

MARKETING TRANSACTIONS

NOTICE OF PROPOSED RULEMAKING

AGENCY: Agricultural Marketing Service

ACTION: Proposed rulemaking

SUMMARY: This action defines by regulation the various storing and marketing transactions which can develop from transactions involving deposited grain in the operation of a licensed grain warehouse and which are subject to the terms and provisions of the United States Warehouse Act. The action further provides for bonding to support certain transactions for deposited grain which warehousemen may have involving the marketing, handling, and shipping of producer-owned grain other than as storage. Also, modest increases in the amount of bond, in the minimum bond requirements, and in minimum net asset requirements for regular storage transactions are specified. Interested persons are invited to submit written comments on the proposed regulations.

EFFECTIVE DATE: Written comments should be filed not later than _____ (60 days after publication of this notice in the Federal Register).

ADDRESS: Comments should be filed in triplicate with the Hearing Clerk, U.S. Department of Agriculture, 14th & Independence Avenue, S.W., Washington, D.C. 20250, where they will be available for public inspection during regular business hours.

FOR FURTHER INFORMATION CONTACT:

Dr. Orval Kerchner, Chief
Warehouse Development Branch
Warehouse Division
Agricultural Marketing Service
Department of Agriculture
Washington, D.C. 20250 (202-447-3616)

SUPPLEMENTARY INFORMATION:

Notice is hereby given in accordance with the administrative procedure provisions in 5 U.S.C. 553, that the Agricultural Marketing Service (AMS), pursuant to the authority conferred by section 28 of the U.S. Warehouse Act (7 U.S.C. 268, hereinafter the "Warehouse Act"), is amending the warehouse regulations for the storage of grain appearing in Part 102 of Subchapter E of Chapter 1 in Title 7 of the Code of Federal Regulations (7 CFR Part 102).

The U.S. Warehouse Act was passed by Congress in 1916. The Act provides for the licensing of such warehousemen as may apply to the Secretary of Agriculture, and (1) meet departmental standards, (2) agree to abide by the law and the regulations thereunder, and (3) who are, in the Secretary's discretion, proper warehousemen within the intent of the law for the storage of agricultural products.

The primary objectives of the U.S. Warehouse Act are to: (1) protect producers and other who store their property in public warehouses; (2) assure the integrity of warehouse receipts as documents of title to be used as collateral for loans, and to facilitate trading in interstate commerce of agricultural commodities; and (3) set and maintain a standard for sound warehouse operations.

A warehouse receipt is acceptable only when it has integrity. Integrity means that the original depositor or a subsequent holder of a receipt must have reasonable assurance that the product covered by the warehouse receipt will be returned upon surrender of the receipt and a valid request for delivery. Failing to receive return of the product, the depositor or holder of the receipt must have the further assurance that the warehouseman is able to pay him for this breach of contract. Existing regulations deal adequately with the warehouseman's obligations and duties as a storer of grain.

Most, if not all, licensed warehousemen also operate a grain marketing business buying grain from producers through the same facilities used for the storage of grain. As grain is received over the scale, the perfect situation would be that it is either deposited for storage with a warehouse receipt demanded and issued or sold with payment demanded and made. However, often the grain's status is not declared by the owner as delivered; or it is deposited for storage with no receipt demanded or issued; or it is sold and payment not demanded or made. The sale or other disposition of grain deposited in a licensed warehouse leads to a full marketing relationship between the depositor and the warehouseman.

The usual marketing relationships have been complicated by another kind of transaction commonly known as price later or deferred pricing or delayed price grain. Such a transaction may be described as a sales contract that constitutes a bonafide sale and change of ownership from the seller to buyer, but which permits the seller to fix the price of the grain at a later date at a pre-agreed formula for determining such price. The seller may continue to have some control of the pricing of his grain but has no physical claim. Generally, no advance payment is made to the seller. The buyer has only a grain payable position with the seller. The seller has only a money receivable position, a common creditor status.

The business of storing and marketing often becomes inseparable and likewise the funds available to the total business often cannot be segregated. These situations create continuous, dual and at times uncertain obligations.

Consequently, there are risks for producers who sell deposited grain as well as for producers who store such grain. It therefore becomes consistent with objectives of the Act to define the various marketing transactions of a licensed grain warehouseman which are the regulatory concern of the Secretary under terms of the Act. A warehouseman engaging or about to engage in marketing activities with or on behalf of producers must give an initial notice to the Secretary and thereafter provide bond to protect such producers. Failure to do so will be cause for suspension of license.

A sound warehouse operation must originate from a sound financial base, and depositors in licensed warehouses must be assured that they will have financial protection if a warehouseman's financial base worsens. The bonding requirements specified in these regulations to support a warehouseman's marketing transactions and the increases indicated in amount of the bond, in minimum bond requirements, and in minimum net asset requirements, are justified in order to maintain the acceptability and integrity of the Federal warehouse receipt; to protect a depositor's interest in commodities deposited in licensed warehouses; and to continue a sound system of warehouses for storage of agricultural commodities.

These actions will affect most grain warehousemen now licensed under the Act and those who may in the future decide to apply for license. The regulations defining the various storing and marketing transactions involving deposited grain generally conform to situations which already exist and it is contemplated that any new "procedures and requirements approved by the Secretary" shall only be those which are already recognized as good business practices. The proposed actions will enhance the security offered by licensed warehousemen to depositors and producers.

The economic impact on small entities is negligible. Operating under the Act is a voluntary election on the part of the grain warehousemen. There presently are 1,835 grain warehouses licensed under the Act. This represents about 18 percent of the estimated 10,000 grain warehouses, 1,767 or 96.3 percent

have a minimum net asset position exceeding that required; and 1,810 or 98.6 percent already are furnishing a bond in excess of the minimum required by these regulations. Any burden resulting from these regulations may cause some warehousemen now licensed to terminate their licenses and some persons who might have applied not to do so.

The regulations, therefore, are amended as follows:

1. Section 102.2 (l) and (n) (7 CFR 102.2 (l) and (n)) are amended, and a new (w) (x) and (y) are added as follows:

Section 102.2 Terms defined.

* * * * *

(l) Warehouse - Unless the context otherwise clearly indicates, any building, structure, or other protected enclosure licensed or to be licensed under the Act, in which grain is or may be deposited for storage, marketing, handling, shipping, or other disposition.

(n) Warehouseman -- Any person lawfully engaged in the business of receiving grain for storage, or who sells, handles, ships or otherwise markets deposited grain and who holds an effective warehouseman's license under the Act.

* * * * *

(w) Deposit -- A lot or parcel of grain received into a warehouse licensed under the Act for storage, marketing, handling, shipping, or other disposition.

(x) Depositor -- A person making or who has made delivery of grain to a warehouse licensed under the Act for storage, marketing, handling, shipping or other disposition and/or who holds a warehouse receipt, contract or other documentation of such delivery.

(y) Producer -- A depositor who also is the landowner, landlord or tenant involved in the production of the grain being deposited.

* * * * *

2. Section 102.6 (a) is amended as follows:

Section 102.6 Net assets.

(a) Each warehouseman conducting a warehouse licensed, or for which application for a license has been made, under the regulations in this part, shall have and maintain above all exemptions and liabilities, total net assets

liable for the payment of any indebtedness arising from the conduct of the warehouse in the amount of at least 20 cents per bushel for the maximum number of bushels of grain that the warehouse could accommodate when stored in the manner customary to the warehouse as determined by the Administrator: PROVIDED, that no person may be licensed as a warehouseman under the regulations in this part unless he has allowable net assets of at least \$25,000: AND PROVIDED FURTHER, That any deficiency in net assets required above this \$25,000 minimum may be supplied by an increase in the amount of the warehouseman's bond in accordance with section 102.14 (a). In determining total net assets, credit may be given for insurable property such as building, machinery, equipment, and merchandise inventory, only to the extent that such property is protected by insurance against loss or damage by fire. Such insurance policies shall be in the form of lawful policies issued by one or more insurance companies authorized to do such business and subject to service of process in suits brought in the State in which the warehouse is located.

3. Section 102.7 is amended by changing "\$10,000.00" to "\$25,000.00".

* * * * *

4. Section 102.9 (a) is amended by changing "\$10,000.00" to "\$25,000.00".

* * * * *

5. Section 102.14 is amended as follows:

Section 102.14 Amounts of bond; additional amounts.

(a) The amount of bond to be furnished for each warehouse under the regulations in this part shall be fixed at a rate of 20 cents per bushel of licensed capacity: PROVIDED, That in any case the amount of bond shall not be less than \$25,000 or more than \$500,000, except as prescribed herein and in subsection (b) of this section. The licensed capacity shall be the maximum number of bushels of grain that the warehouse could accommodate as determined under section 102.6 (a). In case of a deficiency in net assets above the \$25,000 minimum required under section 102.6, there shall be added to the amount of bond an amount equal to such deficiency. In any other case in which the Secretary, or a designated representative, finds that conditions exist which warrant requiring additional bond, there shall be added to the amount of bond as determined under the other provisions of this section, a further amount to meet such conditions.

(b) A warehouseman who contracts with producers to buy, sell, handle, ship, or otherwise market their deposited grain shall give notice to the Secretary prior to first engaging in such activity, and there shall be added

to the amount of bond determined in accordance with paragraph (a) of this section an amount equal to 10 cents per bushel of licensed capacity, provided that such addition for this purpose shall not be less than \$25,000 nor more than \$250,000 in any case. Such increased amount of bond shall be solely for the benefit of producers who contract with the warehouseman to sell, handle, ship or otherwise market their grain in accordance with section 102.44 (b) hereof. Failure to give such notice or to provide such additional bond shall be grounds for suspension of the warehouse license.

(c) In case a warehouseman is licensed or is applying for licenses to operate two or more warehouses in the same State he may give a single bond meeting the requirements of the Act and the regulations in this part to cover all his warehouses within the State. In such case the warehouses to be covered by the bond shall be deemed to be one warehouse only for purposes of determining the amount of bond required under paragraphs (a) and (b) of this section.

* * * * *

6. Section 102.30 is amended as follows:

Section 102.30 Receipts for deposited grain.

(a) Receipts or other documentation indicating delivery to the warehouse must be issued for all grain deposited in a warehouse.

(b) Receipts need not be issued against nonstorage grain, but each warehouseman shall keep accurate records of the weights, kinds, and grades of all lots of nonstorage grain received into and delivered from his warehouse. Whenever the purpose for which any lot of nonstorage grain was received into a warehouse is changed so that its approximate delivery period from the warehouse becomes indeterminate, receipts shall be issued to cover such grain. Records required under the section with respect to nonstorage grain shall be retained, as a part of the records of the warehouse, for a period of one year after December 31 of the year in which the lot of nonstorage grain is delivered from the warehouse.

(c) Accurate records shall be maintained by the warehouseman for grain which the warehouseman moves direct from the producer to a terminal processor, river, or other point of delivery and which does not enter or is not handled through the licensed facility as well as for any nonstorage grain placed in temporary and nonlicensed areas.

* * * * *

7. Section 102.44 is amended as follows:

Section 102.44 Grain Deposits.

(a) All grain received into a licensed warehouse is deemed to be deposited subject to U.S. Warehouse Act and the terms and regulations applicable thereunder. Whoever deposits grain shall receive from the warehouseman a warehouse receipt or other documentation evidencing such deposit. The receiving, documentation, recording, marketing, handling, disposition, and protection of such grain including proceeds therefrom shall be in accordance with procedures and requirements approved by the Secretary and consistent with conditions existing at the warehouse where such grain is deposited.

(b) Persons, including producers, who store grain with the warehouseman and who fail to have such grain or any part thereof returned to them shall have access to the bond provided for in section 102.14 (a) and (c); producers who sell their deposited grain or contract with the warehouseman to be their agent to handle, ship, or otherwise market the grain deposited and who do not receive full payment for their grain in accordance with such sales agreement or contract shall have access only to the increased amount of the bond provided for in section 102.14 (b) and (c). All claims against either part of the bond shall be without preference and on a pro-rata basis.

(c) Except as provided in section 102.27, each warehouseman shall accept all storage and nonstorage grain and shall deliver out all storage and nonstorage grain, other than specially binned grain, in accordance with the grades of such grain as determined by a person duly licensed to inspect and grade such grain and to certificate the grade thereof and in accordance with the weights of such grain as determined by a person duly licensed to weigh such grain and to certificate the weight thereof, under the Act, and the regulations in this part; or if an appeal from the determination of an inspector has been taken, such grain shall be accepted for and delivered out of storage in accordance with the grades as finally determined in such appeal.

* * * * *

This proposal has been reviewed under the USDA criteria established to implement Executive Order 12291, "Federal Regulation." A determination has been made that this action should be classified as non-major under those criteria. Licensed grain warehousemen already engage in the marketing transaction which are regulated herein. Grain warehouses operating under the Act (and the proposed regulations apply only to such warehouses) generally have records and use procedures which are adequate to meet the new requirements; and any added burden in this respect would fall only on the Department in having to examine and develop information from such records.

The Administrator of Agricultural Marketing Service has determined that this action will not have a significant economic impact on a substantial number of small entities because of the proposed increase in the amount of bond, in the minimum bond requirements and in minimum net asset requirements. While there are some 1,835 licensed grain warehouses, 53% (972) of which could conceivably in termed small entities (total capacity of less than 1,000,000 bushels) only a small number, 68 or 3.7% have a net asset position below that to be required and only 25 or 1.4% are furnishing bond less than that to be required.

Done at Washington, D.C.,

/S/ W. T. Manley 6/3/81

GRAIN WAREHOUSES BANKRUPTCIES (1975-1981)*

CAUSES OF BANKRUPTCIES

Between January 1975 to present, there have been 177** grain elevator bankruptcies. The enclosed report gives a breakdown by State and by year.

Based on a review of the bankruptcy cases involving Federally licensed warehouses and/or warehouses with an Uniform Grain Storage Agreement over the last two years, the following conclusions have been drawn.

There are at least two factors that cannot be quantified based on our judgment and our review of the cases. We believe that two of the major causes of grain elevator bankruptcies are the recent state of the economy and the high interest rate being charged for business loans during the past several years.

Commercial and industrial failures rose 55 percent in 1980, the most in 13 years, according to Dun & Bradstreet. Therefore, business failures are not unique to the grain business. The increase in grain elevator failures followed the general business trend.

With respect to the specific causes that can be quantified, we have prepared a chart which is enclosed.

* Material Submitted by States upon the request of the Elevator Task Force Working Group.

** A compilation report from the 50 States.

Number of Bankruptcies by State

Alabama	1	Minnesota	8
Arkansas	2	Montana	4
California	1	Nebraska	4
Colorado	5	New York	1
Florida	2	North Carolina	5
Georgia	1	North Dakota	1
Idaho	1	Ohio	12
Illinois	10	Oklahoma	2
Indiana	22	Oregon	5
Iowa	35	South Carolina	4
Kansas	5	Texas	5
Kentucky	1	Utah	1
Louisiana	4	Virginia	1
Maryland	3	Washington	1
Michigan	12	Wisconsin	4
Missouri	14		
TOTAL		177	

Number of Bankruptcies by Year

<u>1975</u>	<u>1976</u>	<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>
15	30	29	20	37	37	4

Warehouse Name and Address	Date	Possible Criminal Activity	Poor Management	Inadequate Record Keeping	Possible Diversion of Funds	Collateral Warehouse Receipts	Quality/Quantity Problems	Futures Market Speculation	Delayed Pricing Contracts	Unknown
Bremen Farmers Coop Bremen, Kansas	7/9/80		X							Financial Difficulty
E.L. Rivenbark & Son Tabor City, N. Carolina	7/18/80		X	X		X	X		X	
Courtenay Farmers Coop Courtenay, No. Dakota	7/23/80		X	X			X			
Miller Feed & Grain McCausland, Iowa	8/8/80	X	X	X		X				
James Brothers Whses. Frisbee Cotton Co. Ristine, Mo. Caruthersville, Mo. Holcomb, Mo. James Gin & Elevator Naylor, Mo.	8/11/80	X	X	X	X	X	X	X	X	
Cox Cotton Co. Corning, Ark. Piggott, Ark. Pocahontas, Ark. Reyno, Ark. W. Memphis, Ark.	8/11/80	X	X	X	X	X	X	X	X	
James Agri-Center Neelyville, Mo.	8/11/80	X	X	X	X	X	X	X	X	
James-Farm Center Knobel, Ark.	8/11/80	X	X	X	X		X	X	X	
Hoarty Grain Co. Munster, Illinois	8/26/80	X	X	X	X	X				Financial Difficulty
Farmers Union Elev. Co. Russell, Minnesota	9/2/80						X			

Warehouse Name and Address	Date	Possible Criminal Activity	Poor Management	Inadequate Record Keeping	Possible Diversion of Funds	Collateral Warehouse Receipts	Quality/Quantity Problems	Futures Market Speculation	Delayed Pricing Contracts	Unknown
Hanson Elevator Dixon, Nebraska	3/15/79	X	X	X	X			X		Financial Difficulty
Farmers Elev. of Elmore Elmore, Minnesota	3/29/79	X	X	X	X	X			X	
La Paz Grain Co. La Paz, Indiana	3/30/79	X	X	X						
Farmers Elev. Co., Inc. Kingsmill, Texas	4/25/79					X	X			
Boswell Grain Elev. Boswell, Indiana	8/20/79	X	X	X		X		X	X	
Muhr Grain Co. Orient, Iowa	9/12/79	X	X	X	X					
Seney Grain Inc. Seney, Iowa	10/4/79	X	X	X						
Boise City Farmers Coop Boise City, Okla.	11/16/79		X	X			X			
Union County Coop Island City, Oregon	11/14/79									Financial Difficulty
Barnard Coop Assn. Barnard, South Dakota	12/21/79									Financial Difficulty
Western Farmers Assn. Wallula, Washington	12/31/79									Financial Difficulty
Wieston Grain Co. Wieston, Iowa	1/15/80									Financial Difficulty
Prairie Grain Co. Stockport, Iowa	2/15/80	X	X	X	X			X		

Warehouse Name and Address	Date	Possible Criminal Activity	Poor Management	Inadequate Record Keeping	Possible Diversion of Funds	Collateral Warehouse Receipts	Quality/Quantity Problems	Futures Market Speculation	Delayed Pricing Contracts	Unknown
Traders Grain, Inc. Nebraska City, Neb.	10/8/80	X	X	X						
Collins Grain Co. Kackley, Kansas	11/5/80	X	X	X		X				
Berg Grain Co. Creston, Illinois	1/7/81						X			Financial Difficulty

STATEMENT BY JOHN R. BLOCK
SECRETARY OF AGRICULTURE
before the
COURTS SUBCOMMITTEE OF THE SENATE JUDICIARY COMMITTEE

April 6, 1981

Mr. Chairman, members of the Subcommittee, I appreciate this opportunity to testify today on grain warehouse failures and their effect on the agricultural community. C. W. McMillan, Assistant Secretary for Marketing and Transportation Services, is with me to address your concerns.

I do not feel that discussing this matter in terms of the "agricultural community" overstates the issue. Because banks frequently accept a warehouse receipt as collateral, the insolvency of a given warehouse or elevator affects farmers, the government and its warehouse programs, and the financial community.

I want you to know that the Department of Agriculture understands the scope and severity of the issue before us, and appreciates the subcommittee's interest and desire to be of help.

We have reviewed the Chairman's bill to amend the Bankruptcy Act and note the provision for fast removal of agricultural commodities in bankrupt warehouses. The Department is not in a position at this time to offer an assessment of the proposed bill. However, we can offer some insight into the problem as we see it today.

I believe that a key point is the fact that USDA regulates only those grain warehouses that elect to be licensed under the Federal Warehouse Act or elect to be approved by the Commodity Credit Corporation. These warehouses must be examined periodically and these examinations must be performed or supervised by USDA.

The U. S. Warehouse Act also regulates grain storage in federally licensed warehouses. These regulations, which pertain to warehouses' net worth, are designed to assure solvency of warehouses storing grain under the Act.

It has been estimated that there are about 10,000 grain elevators and warehouses operating in the United States. As of the end of FY 1980, there were 1,828 of these with a storage capacity of about 3 billion bushels licensed under the U. S. Warehouse Act. Most of these elevators or warehouses also have an approved CCC storage agreement. There were about 6,300 grain facilities with storage capacity of about 6 billion bushels approved for storage agreements with CCC as of the end of FY 1980. Therefore, there are many grain elevators or warehouses that operate solely under State regulation and supervision or no regulation at all.

Our Office of Inspector General has reviewed warehouse regulations for 16 states. The findings are that state requirements for net worth and bonding vary considerably among states and are generally less stringent than federal requirements.

I believe that this information makes relevant the findings of a study by the Illinois Legislative Council on Grain Elevator Bankruptcies.

According to that study, 22 grain producing and midwestern states reported 104 grain elevator bankruptcies in the United States between 1974 and 1979. The number of farmer-claimants for all reported bankruptcies was just over 3,000. There were 420 other claimants.

The real significance of this information is the fact that only two of the 104 bankrupt elevators were federally licensed and the required U. S. Warehouse Act bond protected the grain depositors.

As a result of a recent and widely noted grain elevator bankruptcy the Department, at my request, is doing something.

Just one month after coming into office, on February 26, I appointed a USDA Task Force to review current grain warehouse laws and regulations. I have asked the Task Force to tell me what needs to be done to safeguard the interests of all--farmers, consumers and those with a financial stake--in the event of elevator bankruptcies.

The Acting Administrator of the Agricultural Stabilization and Conservation Service is chairing the Task Force. The group includes representation from a cross-section of USDA agencies and brings a substantial amount of Department expertise to address this issue.

The Task Force has published notice in the Federal Register asking the public to comment by April 15 on warehouse bankruptcies and protecting the common interest. The group has also asked all states for detailed information on elevator bankruptcies within their jurisdiction. Task Force members are meeting with farm organizations and representatives of the warehouse industry for addition information.

I must stress at this time that the USDA Task Force is not focusing on specific elevators or areas of the country. Nor will they respond to questions on specific bankruptcy cases.

I understand that there may be an impression in some quarters that a wave of insolvencies is imminent. USDA does not believe this is true. Our interest in this matter springs from our desire to evaluate whatever problem exists right now, and not from any anticipation of a greater problem. We do not, at this time, wish to offer a suggested solution.

The fact is that there is very little documentation on the warehouse and elevator bankruptcy issue in the U.S. We in USDA want to lend our expertise.

We want to work with the Subcommittee toward making the changes which may be necessary to protect the many sectors of the agricultural community from the damage that results from grain warehouse failures.

Thank you for this opportunity to comment.

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STATEMENT BY
RAYMOND D. LETT
EXECUTIVE ASSISTANT TO THE SECRETARY, USDA
BEFORE THE
SENATE JUDICIARY COMMITTEE
SUBCOMMITTEE ON COURTS
MAY 18, 1981

Mr. Chairman and members of the Subcommittee, I appreciate this opportunity to appear before you today to report actions taken to date by the Department of Agriculture on the matter of grain warehouse failures and their effects on the agricultural community.

First, I wish to review briefly what we have done. This issue surfaced some months ago in New Madrid County, Missouri, where a group of farmers had been unable to settle their claims against a bankrupt elevator. The attention given this incident was nationwide and was not restricted to the agricultural sector alone. It did cause tremors throughout agriculture because it focused attention on a potential problem that could have ramifications far beyond those affecting only the producers of the grain and the operator of the elevator.

Recognizing this, Secretary Block announced on February 26 formation of a special task force to review current grain warehouse laws and regulations and to recommend possible changes to lessen the likelihood of such insolvencies.

On April 26, Secretary Block named me as permanent chairman of the Elevator Task Force Executive Committee and Edward Hews, then-acting Administrator of ASCS, as chairman of the Task Force's Working Group. He also appointed four others to the Executive Committee: Seeley Lodwick, Undersecretary of Agriculture for International Affairs and Commodity Programs; William Leshner, Assistant Secretary of Agriculture for Economics; C. W. McMillan, Assistant Secretary of Agriculture for Marketing and Transportation Services; and James Barnes, General Counsel-designate of the Department.

On May 12 and 13, meetings were held at the Department with an informal Ad Hoc Group made up of the representatives of the agri-business community.

As Secretary Block pointed out in his April 6 testimony before your Subcommittee, USDA regulates only those warehouses that elect to be licensed under the U. S. Warehouse Act or elect to be approved by the Commodity Credit Corporation. Such warehouses must be examined periodically and these examinations must be performed or supervised by USDA.

As of October 1, 1980, there were licensed under the U. S. Warehouse Act the following: 228 cotton warehouses with storage capacity of 9,873,000 bales, representing 54 percent of the commercial cotton storage; 1,808 grain elevators with a storage capacity of 3,085,283,000 bushels, representing 43 percent of commercial grain storage; and 74 warehouses storing other agricultural commodities. Over 70 percent of the U. S. cotton crop will be stored in a Federally licensed warehouse sometime before use, and some 30 percent of the nation's grain producers deal with Federally licensed elevators delivering an even higher percentage of the nation's output of grains.

A compilation of reports submitted by the 50 states shows between January 1975 and the present a total of 177 grain elevator insolvencies. In providing this information, the states may have only counted actual insolvencies, not cases where an operating license had been withdrawn prior to actual insolvency. Reviewing the cases involving Federally-licensed warehouses and/or warehouses with a Uniform Grain Storage Agreement over the last two years, we have been able to draw certain conclusions.

First, there are at least two factors that cannot be quantified, based on our judgment and review. We feel that two of the major causes of grain elevator bankruptcies are the recent state of the economy and the high interest rates being charged for business loans during the past several years. Dun and Bradstreet reports that commercial and business failures rose 55 percent in 1980--the most in 13 years. In 1980 alone, there were almost 12,000 failures in all industries. So, business failures are not unique to the grain business.

We have been able to quantify some causes, covering such areas as poor management, inadequate record keeping, possible diversion of funds, collateral warehouse receipts, quality/quantity problems, futures market speculation, delayed price contracts, and some simply "unknown".

Before I go into some of the specific options our working group has developed, I wish to stress the importance of reviewing all the alternatives available to the government and trade pertaining to this important subject. Many areas of discussion do not appear to be feasible or are too costly to consider.

We do, however, have general consensus on what some of the major issues are and which of these issues are worthy of further consideration.

First, we believe most people agree there is no need to create a new Federal agency to deal with the problem of elevator insolvency. Neither is there any significant support for some form of insurance or indemnity program.

We are aware of various legislative proposals to amend the Federal bankruptcy laws and have been studying them, but our review is not completed and the Department does not wish to make specific comments on the different bills at this time. The bankruptcy laws are drawn to help solve a problem that has been created, rather than prevent it from happening in the first place, and revision in itself would not be an entire answer where elevator insolvencies are concerned. In our work at the Department, merely because we have not as yet concentrated on these proposed changes in the bankruptcy laws to the degree we have in other fields, does not mean in any sense

that we preclude such changes as options. We are definitely approaching the changes with an open mind. Our work, though, has been concentrated on what can be done by the Department to head off insolvencies, if possible, or mitigate the effects of those insolvencies that do occur.

We believe that a combined Federal-State effort would be most beneficial and efficient. Secretary Block stressed a combined effort when he appeared before the Ad Hoc Group, Executive Committee and its Working Group at our May 12 meeting. He said the States can certainly take a greater role; that duplicate efforts can be avoided; and that there can be more Federal/State coordination than in the past. He said the Administration wishes to give a greater role to the States in as many areas as possible.

I would like now to turn to a set of options. Some, if implemented, could be done administratively. Others would require legislation.

First, what should be the role of USDA when potential insolvencies are threatened? Historically under the Warehouse Act, the role of the Department has been a passive one. Present authority under Sections 12 and 25 of the Warehouse Act provides for suspension and revocation of licenses, when licenses violate certain provisions of the Act, and Section 30 spells out penalties for those violating operating principles.

The Department is considering what it could do to become more active. Under the auspices of the Office of the General Counsel, we are reviewing what actions we might take under the Warehouse Act to deal with threatened or actual insolvencies.

Second, the current Commodity Credit Corporation Standards of Approval for Warehouses could be amended to conform with standards required under the Warehouse Act and both could require submission of an unqualified financial statement prepared by an independent Certified Public Accountant. We would continue to require at least one warehouse examination per year.

If required, the Department could ask assistance from the Office of the Inspector General for a special review to determine the cause of financial deterioration of a warehouse. This could be sought as a result of a warehouse examination or on analysis of the certified financial statement. Appropriate action could then be taken deemed in the best interest of grain claimants. We would continue to use such ratios as debt to equity; receivable to payables; current assets to current liabilities, etc., and a system to monitor trends over a period of three or more years to assure that the warehouseman's financial condition was not deteriorating.

An unqualified CPA statement is a good working tool for managerial and regulatory personnel when it contains an operating statement, a verification of claimed inventory, a confirmation of storage (grain) obligations, and accounts for grain payables, bank loans and a market position. This sort of audit will bring to light items easily ignored or overlooked by company accountants, which are usually the result of mediocre and/or inadequate records without controls. The Department could use the CPA statement as a general guideline to give priority to examining warehouses where statements show the need for closer review.

The third option deals with assets and bonding. CCC could change its requirements

to put them on par with the net worth required by the U. S. Warehouse Act, and would continue to enable warehousemen to provide CCC with a bond or other negotiable securities approved by CCC when a deficiency in net worth occurs.

Fourth, CCC could amend its Standards of Approval for storage contracts to require that warehouses be either licensed by the U.S. Warehouse Act or by a State which has laws and regulations comparable to the Act. All warehousemen must meet the Standards of Approval prior to CCC entering into a contract. At the present, State laws and regulations vary widely. Some are more stringent than those of the CCC and the Warehouse Act, some much less, and some have no laws or regulations whatsoever.

The fifth option concerns uniform licensing and regulations. Some States have legislation and regulations similar to those of the Federal Government; many do not. Some of the States' requirements are strong; some are not. Where there is legislation the Federal system offers a choice of operation. The Federal Government could focus its attention in areas where inadequate State legislation and/or enforcement exists.

A sixth option would be to amend the Standards of Approval to provide for acceptance of irrevocable letters of credit as a substitute for a bond for warehousemen having a deficiency in their net worth.

The seventh option we are considering is in the area of marketing activities. In the last several years risks for producers in dealing with grain warehouses have shifted from the storage to the marketing operation. Almost all elevators that store grain also buy grain. Delayed Price and Deferred Payment contracts have lessened the amounts of grain stored and increased accounts payable for grain. These have contributed to losses in operating capital and, in some cases, insolvencies. For some time the Department has been considering regulations which would give some protection to users of Federally licensed warehouses that deposit their grain for other than storage purposes. These regulations would define the various transactions essential to such an operation and provide for bonding to support them.

An eighth option is, simply, information. We perceive a general need for farmers, warehousemen-dealers, bankers, insurance and surety industries, and the legal profession to have greater exposure to their related procedures, obligations, risks and legal liabilities in the marketing and/or storing of agricultural products. This need will certainly increase as our Task Force makes its findings public, as new legislation is proposed, considered and acted on in the Congress, and as changes are implemented by Federal and State regulatory agencies.

We will have to identify the audience, determine how best to reach it, decide the content and form of the message we wish to convey, and the actions we want as a result. We will need to utilize professional expertise within the Department as to preparation, most effective carrier, and content. The message must be timely, interesting, concise, precise and touch the needs of all concerned. It will not be easy to do this but we feel it is essential.

A ninth option that would be ancillary to the information program would be to establish

of information among the industry, government agencies, and grain producers. A section could be established in the Department of Agriculture to monitor grain elevators and warehouses and would help in anticipating emerging problems. It would also develop case studies to provide in-depth analysis of grain elevator failures.

When the Department initiated its work on the matter of elevator insolvencies, we stressed that answers would not come quickly nor easily. We do believe we have been able to target major areas of concern and come up with some very pertinent options for further consideration, while recognizing and discarding those that simply are not feasible for various reasons.

There are pros and cons on every single option I have presented to the Subcommittee today. We have been able to identify where our further efforts should be concentrated. Some of these proposed changes, we will find, may be done administratively; others, we will also find, would require new legislation. There has been no attempt to make that distinction to date. We do believe we are on the right track, and if further work proceeds at the pace at which our past efforts have moved--and I believe it will--we will be able to pursue the appropriate options.

Thank you for the privilege of appearing before you and I will be happy to answer any questions the Subcommittee might have.



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